

UNIVERSITY OF HAWAI‘I SYSTEM ANNUAL REPORT



REPORT TO THE 2009 LEGISLATURE

Annual Incentive & Performance Report
and
Report by the UH Task Force on Developing a Budgetary
System and Funding Formula for Distribution of Fiscal
Resources to UH Campuses for 2009

Act 188, SLH 2008 (Sections 2 and 3)

January 15, 2009

Act 188 of the Session Laws of Hawai'i 2008 established a task force to assist the University of Hawai'i in developing a

budgetary system that includes an equitable, consistent, and responsive funding formula for the distribution of fiscal resources to the various University of Hawaii campuses. The funding formula shall:

- (1) Be linked to the enrollment of full-time equivalent (FTE) students at each campus;*
- (2) Assign different weights in recognition of the varying costs and revenues relating to educating different categories of students...*

In accordance with the statute, the task force was convened with the following members:

Gene Awakuni, Chancellor, UH-West Oahu
Virginia Hinshaw, Chancellor, UH-Manoa
John Morton, Vice-President, UH Community Colleges
Senator Norman Sakamoto, appointed by the President of the State Senate
Rose Tseng, Chancellor, UH-Hilo
Carol Ann VanCamp, appointed by the Speaker of the House of Representatives

Senator Sakamoto and Vice-President Morton were selected to serve as co-chairs of the task force.

As provided by the law, the task force solicited proposals for a consultant to assist with the development of the funding formula. Proposals were solicited from four national firms with experience in developing state funding formulas and, by unanimous consent, the task force selected Mary McKeown-Moak of MGT of America, Inc. as the consultant.

Working with data provided by UH and from national data sources, the consultant and the task force have been considering various approaches and methods of formula funding. A discussion of some of the principles of formula funding and of accountability or performance funding as presented by the consultant are included as Attachment A and Attachment B.

The Task Force continues its work and is now focusing on those factors that should be included in any formula to provide the type of equitable funding and performance incentives as described by the law. There is a recognition that the formula must reflect the different missions and associated costs of the different components of the University, the differences in cost associated with size, scale, and geographic location, and costs associated with providing incentives in achieving the identified strategic outcomes of the University. The Task Force anticipates that the recommendation for a funding formula can be completed in Spring 2009.

The work of the task force, including all minutes of meetings and related documents may be viewed at <http://www.hawaii.edu/act188/>.

Attachment A

Guiding Principles in Formula/Guideline Usage

Over time, a number of researchers in the area of higher education finance have offered their concepts regarding desired characteristics in state higher education funding formulas. Frequently, what is offered as the “desired characteristic” is in direct response to a perceived shortcoming of a particular state’s funding formula or guideline.

Fourteen characteristics, listed and summarized below in no particular order of importance from A to N, often tend to be in opposition to one another. For instance, the desire to have a simple-to-understand funding formula may preclude features that might contribute to a greater degree of equity (e.g., more detailed sub-categories to reflect institutional differences). Similarly, a formula that is responsive to changes in enrollment levels may not be able at the same time to provide the desired level of stability. Use of the characteristics provides an objective framework for evaluating funding policy alternatives – both during the phase of review of the current formula and in subsequent years. There will be many alternatives and options for funding formulas – an accepted, pre-established set of guiding principles provides a rationale for narrowing down this list of options.

Act 188 includes some guiding principles for the University of Hawai`i System:

- ***Recognize the unique missions and roles of the campuses;***
- ***Recognize the higher education needs of the State;***
- ***Be equitable;***
- ***Be consistent;***
- ***Be responsive to changes;***
- ***Recognize needs of students with special needs;***
- ***Recognize students enrolled in programs that address the major workforce needs of the State;***
- ***Include an incentive and performance component;***
- ***Be used as a basis for planning;***
- ***Provide for accountability; and***
- ***Be as simple and transparent as possible.***

Desired Characteristics of a Funding Formula or Guideline

Characteristic	Summary Description
A. Equitable	The funding formula should provide both horizontal equity (equal treatment of equals) and vertical equity (unequal treatment of unequals) based on size, mission and growth characteristics of the institutions.
B. Adequacy-Driven	The funding formula should determine the funding level needed by each institution to fulfill its approved mission.
C. Goal-Based	The funding formula should incorporate and reinforce the broad goals of the state for its system of colleges and universities as expressed through approved missions, quality expectations and performance standards.
D. Mission-Sensitive	The funding formula should be based on the recognition that different institutional missions (including differences in degree levels, program offerings, student readiness for college success and geographic location) require different rates of funding.
E. Size-Sensitive	The funding formula should reflect the impact that relative levels of student enrollment have on funding requirements, including economies of scale .
F. Responsive	The funding formula should reflect changes in institutional workloads and missions as well as changing external conditions in measuring the need for resources.
G. Adaptable to Economic Conditions	The funding formula should have the capacity to apply under a variety of economic situations , such as when the state appropriations for higher education are increasing, stable or decreasing.
H. Concerned with Stability	The funding formula should not permit shifts in funding levels to occur more quickly than institutional managers can reasonably be expected to respond.
I. Simple to Understand	The funding formula should effectively communicate to key participants in the state budget process how changes in institutional characteristics and performance and modifications in budget policies will affect funding levels.
J. Adaptable to Special Situations	The funding formula should include provisions for supplemental state funding for unique activities that represent significant financial commitments and that are not common across the institutions.
K. Reliant on Valid & Reliable Data	The funding formula should rely on data that are appropriate for measuring differences in funding requirements and that can be verified by third parties when necessary.
L. Flexible	The funding formula should be used to estimate funding requirements

	in broad categories; it is not intended for use in creating budget control categories.
M. Incentive-Based	The funding formula should provide incentives for institutional effectiveness and efficiency and should not provide any inappropriate incentives for institutional behavior.
N. Balanced	The funding formula should achieve a reasonable balance among the sometimes competing requirements of each of the criteria listed above.

PRINCIPLES FOR ACCOUNTABILITY MEASURES

The driving force behind any performance-based funding model is the desire to establish a formal link between institutional performance and funding received. These are ultimately translated into a system of performance indicators on which the allocation is based.

The concept of what is a “best practice” in measuring the performance of higher education institutions continues to evolve. However, there are a number of guiding principles that are generally accepted as “good practice” in the development of institutional performance measurement mechanisms. Exhibit 1 outlines 11 guiding principles that are presented in no particular order of importance. The process for developing and establishing a system of performance indicators is unique to every enterprise; however, we believe that all 11 of these principles need to be considered during this process to ensure a successful and effective outcome.

These 11 guiding principles have a number of corollaries that should be considered as well:

- ***The expectations for institutional performance should be clearly understood and stated at the outset. Organizations can only “improve” if there is an understanding of the priorities for organizational performance. Clearly, the priorities should grow out of organizational mission and goals, however it is important that these be understood and agreed to by key participants at the beginning of the process.***
- ***The starting place for institutional performance measurement and benchmarks for success varies among institutions. Because each institution operates within its own context, the beginning point for institutional performance measurement will also vary depending on the specific performance indicator. Using “graduation rate” as an example, one institution may be at 45 percent for a six-year graduation rate while another may be at 85 percent. Because these types of variances can be due to a variety of potentially valid reasons, no value judgment should automatically be attached.***

EXHIBIT 1
Guiding Principles For Developing And Establishing
Institutional Performance Indicators

Guiding Principle	Definition
Credibility	The performance indicators should have internal and external credibility among all institutional stakeholders.
Linkage to Mission, Strategic Plan, and Policy Goals	The performance indicators should incorporate and reinforce institutional missions and strategic plans, as well as broad policy goals.
Stakeholder Involvement and Consensus	The performance indicators should be developed through negotiation and consensus among key stakeholders.
Simplicity	The performance indicators should be simple to convey and broadly understood.
Reliant on Valid, Consistent, and Existing Information	The performance indicators should be based on data that are valid and consistent and that can be verified by third parties when necessary. The indicators should also be based on established data sources <u>where possible</u> in order to maximize credibility and minimize additional workload.
Recognizes Range of Error in Measurement	The performance indicators should be established with wide recognition that there are certain unavoidable ranges of error in any performance measurement activity.
Adaptable to Special Situations	The system of performance indicators should accommodate special institutional circumstances where possible.
Minimizes Number of Indicators	The performance indicators chosen should be kept to the smallest number possible in order to minimize conflicting interactions among the indicators and to maximize the importance of each indicator.
Reflects Industry “Standards” and “Best Practices”	The performance indicators chosen should reflect “industry” norms and standards where possible in order to allow for benchmarking and peer comparisons.
Incorporates Input, Process, Output, and Outcomes Measures	The performance indicator system developed should have a balance of measures related to institutional inputs, processes, outputs, and outcomes.
Incorporates Quantitative and Qualitative Measures	The performance indicator system developed should incorporate both quantitative and qualitative measures in order to present the most complete picture of institutional performance possible.

- Performance measures should not be developed only with available data systems in mind. ***Implementing a system of institutional performance measurement requires data to be available. In fact, most institutions develop performance measures with this in mind. This practice has both positive and negative consequences. The ability to work with existing data systems reduces the start-up time and cost to implement a performance indicator system. It also improves the comfort level of those involved, and thus the credibility of the process. On the other hand, limiting an institution's performance measures according to data availability may not result in the most appropriate or meaningful set of measures in the long run. Thus, notwithstanding the benefits of using existing data systems, the development of performance measures should recognize the current availability of data where appropriate, but should be primarily driven by the questions "what are we trying to measure?", and "why?"***
- "Continuous improvement" is not infinite. ***A related issue that must be dealt with in establishing performance measurement mechanisms is the fact that the rate of "improvement" in any given area is non-linear. Institutions may be able to make great strides toward improving certain operational or programmatic areas initially, but then come to a standstill. Or, an institution may move forward in another area and then falter for a period of time. In short, it is important to realize that the process of enhancing institutional performance is imprecise at best and that to expect institutions to "continuously improve" is unrealistic.***

Perhaps the greatest challenge in designing a performance indicator system is to achieve some level of balance among all of these competing, and sometimes contradictory, principles. Again, no one of these principles is more important than the others. Rather, it is important that all be considered during the design and implementation of the system.

Act 188 set out a set of principles that are among those listed above:

- ***Recognize the unique missions and roles of the campuses;***
- ***Recognize the higher education needs of the State; and***
- ***Be as simple and transparent as possible.***