United States Naval Academy Periodic Review Report

June 2011

Chapter Four

Enrollment and Finance Trends and Projections

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In responding to the expectations for Chapter Four of the MSCHE Periodic Review Report, regarding enrollment and finance trends and projections, it is important to first describe the Naval Academy's financial operating environment. The most important characteristics of the Academy's financial environment is that it is *Federally resourced and regulated.* Unlike private and public civilian institutions of higher education, the United States Naval Academy and the other two service academies at West Point (United States Military Academy, USMA) and Colorado Springs (United States Air Force Academy, USAFA) were established by an act of Congress (Title 10-US Code). Statutes, regulations, and guidelines for the justification, receipt, and execution of resources—and for the accounting of these resources—are drawn from the Congress, the Department of Defense (DOD) and the Department of the Navy (DON).

The most important component of USNA funding—and that portion which is the centerpiece of this chapter—flows to the Naval Academy as an annual appropriation from Congress via the Department of Defense and the Department of the Navy. Students do not pay tuition to attend the United States Naval Academy. In fact, they are paid as military officers with part of our appropriated funds. And even more significantly, there is no carry-over of appropriated funds from one year to the next as with civilian institutions. That is, USNA ends the fiscal year with zero budget and starts the next year (on October 1) with budget "controls" or amounts appropriated by Congress. One of the difficulties faced is that if the budget is not passed by Congress before the start of the fiscal year, then the Academy must rely on continuing resolutions that typically use the previous year's "controls" as their base. As was the case during the current fiscal year (FY2011), the budget was not passed until April 2011. We will discuss the implications and challenges of both the appropriation process and continuing resolution situation in describing the shortfalls we have faced and our attempts to re-baseline our appropriated budget.

While quite different from the funding environment of most US colleges and universities, the discussion in this chapter will provide an overview that reflects the financial health and outlook of the Naval Academy. A centerpiece of this discussion is the Cost Per Graduate (CPG) summary found in FY 2009 USNA CPG DATA AND MANPOWER COST REPORT (**Enclosure 4.01)** and details in **4.02**. **Enclosures 4.01** and **4.02** include the most recent available Cost Per Graduate, from Fiscal Year 2009, and are organized around a common template shared among the three military academies: USNA, USMA, and USAFA. They provide a comprehensive overview of all appropriated funds associated with graduating midshipmen with color-coding to indicate the funding sources and functions.

Appropriated Funds: Multiple Federal Funding Sources

Appropriated funds encompass those resources made available to the Department of Defense, Navy, the Marine Corps, and their various sub-units, including the Naval Academy, by an act of Congress that permits these federal entities to incur obligations and to make payments out of the Department of Treasury for designated purposes. Appropriated Funds must be aligned with the mission of the Academy and with the number of midshipmen enrolled. Appropriated Funds most relevant to the Naval Academy's operation include Core Mission funds (color-coded in yellow in **Enclosures 4.01 and 4.02**) and Base Operating Support and Sustainment, Restoration and Modernization controlled by Commander, Navy Installations Command, CNIC (color-coded in blue). This document is referred to internally as the ***38 liner*.**

Core Mission. These resources are typically referred to as Operations and Maintenance, Navy (O&M,N), which is how they are designated in the Department of Defense Appropriation Act. These are the USNA ***Core Mission*** funds. These funds come to the Naval Academy from the Officer Acquitions funding made available by Congressional appropriation to the Chief of Naval Personnel (CNP), who has been the financial overseer of the Academy's O&M,N funding since 2010. Of the Core Mission O&M,N, those funds that support the academic program (Instructional Activities) are

shown in lines 1-7 of the FY 2009 USNA CPG DATA AND MANPOWER COST REPORT in **Enclosure 4.01**. These funds amount to a total of approximately $165M for FY 2009 (see the TOTAL INSTRUCTIONAL ACTIVITIES row and GRAND TOTAL column of **Enclosure 4.01**). Of these Instructional Activities funds, there is some flexibility in allocating only the O&M,N Labor and Material budgets which amount to about $91M (see the TOTAL INSTRUCTIONAL ACTIVITIES row and O&M,N LABOR and O&M,N MATERIAL columns of **Enclosure 4.01**). They cover civilian labor costs and related materials for those functions listed under the ITEM FUNCTION column, lines 1-7. These are the only funds directly related to instructional activities where there is flexibility since they are provided to the Academy as a dollar-based appropriation. USNA efforts to stabilize these funds at a level commensurate with requirements are a central topic of this chapter. For a full description of all the items related to INSTRUCTIONAL ACTIVITIES see the COST PER GRADUATE REPORT FY09 38 Line Detail in **Enclosure 4.02.** It should be noted that the 38 Line Detail table in **Enclosure 4.02** is used to generate the USNA Annual IPEDS report in **Enclosure 4.03** as is shown in the first column of the 38 Line Detail table. The connections between IPEDS and the 38 liner are explained on the cover page for **Enclosure 4.03.**

In contrast, the approximately $74M of Military Personnel, Navy (MPN) is not a dollar-based appropriation, but is the support provided for the Navy and Marine Corps military officers assigned to USNA (see the TOTAL INSTRUCTIONAL ACTIVITIES row and MPN column of **Enclosure 4.01**). These funds are provided to the respective personnel chiefs of the Navy and Marine Corps who are responsible for the pay and allowances for all uniformed personnel. The personnel chiefs in turn assign officer and enlisted personnel—***not the funds***—to the Naval Academy. Since these funds come from the same source as those used by the operating forces of the Navy and Marine Corps, they are always at a premium and are not necessarily stable from year-to-year. As will be discussed later in this chapter, over the last decade the number of military personnel at the Academy has decreased and the number of civilian instructors has increased, which puts additional pressure on the civilian labor budget. In this regard, USNA leadership is trying to reach a balance of 301:301, civilian: military instructors, which would free-up more of the civilian labor budget.

Base Operating Support and Sustainment, Restoration and Modernization funds. Beginning in 2004, the Naval Academy became a *tenant activity* on a base managed and maintained by the Commander, Navy Installations Command (CNIC). Prior to 2004, USNA had control over all O&M,N funds including those for facilities maintenance and renewal. The Superintendent of the Naval Academy oversaw all these functions which gave him considerable flexibility due to the large number of dollars allocated annually, particularly to facilities. Now the Base Operating Support and Sustainment, Restoration and Modernization portion of O&M,N funds are controlled by CNIC, which is responsible for Navy facilities world-wide. USNA new construction, building Restoration and upkeep, police forces, fire protection, and all public works functions including grounds and roads maintenance, custodial services, snow and inclement weather response, and emergency response, are entirely provided by CNIC and the local CNIC representatives who maintain and protect these facilities on behalf of the Navy. All USNA related CNIC appropriated funds total about $100M each year (see the Sub-totals in those lines color-coded blue in **Enclosure 4.01**). Of this total, approximately $55M are devoted to facilities (see Maintenance and Engineering, line 35 Column E Sub-total of **Enclosure 4.01**). For a full description of all the items under each of these categories see the Detailed Cost of Graduates table in **Enclosure 4.02.**

Other Appropriated funds. There are several other noteworthy lines items in the Cost of Graduates table. One is the Naval Academy Prep School (NAPS). The Naval Academy Preparatory School (NAPS), in Newport, RI, is also funded via Title 10 (US Code), but is not included in these discussions since it is located in New England and is not under the jurisdiction of the Middle States Commission on Higher Education (line 31). In addition, the Museum (line 34) and Supply and Services Operations (e.g., Laundry) (line 27) and Medical services (line 12) are funded through other federal agencies. (See these line items in **Enclosure 4.01).**

Reimbursable Funds received from other Navy, DOD, US Government and non-federal entities. In addition to mission funds appropriated wholly or partially with the Naval Academy in mind, there are public and private funds that come to the Naval Academy on what is termed a *reimbursable* basis. Under a prescribed set of rules, the Naval Academy can accept funds from other Navy, DOD, US Government and non-federal entities for work performed by USNA personnel –largely our civilian faculty—in response to jobs requested by these agencies. The funds are called *reimbursable* because the outside agency funds reimburse the Naval Academy for the salaries it is paying out to our staff—in accordance with funding levels and expected outcomes agreed upon in advance—through USNA's payroll and timekeeping authorities. Supplies may also be purchased reimbursably.

Several factors make these funds particularly relevant to the Naval Academy. First, our teaching faculty is paid only for the ten month academic year. The balance of the year they are either in leave without pay status; a paid status from limited mission funds for discrete projects during the summer; or they work on projects for other federal agencies "reimbursably", as described above. Second, because the Academy is geographically situated near several major federal laboratories and Navy or DOD R&D commands, this *reimbursable* relationship is well-developed for USNA faculty, especially in science, technology, engineering and mathematics (STEM) disciplines, and is attractive to both the Academy and the outside agency. From this relationship, the Naval Academy faculty and midshipmen are able to reap the valuable collateral benefit of enhanced faculty professional development and discipline currency. There are about $10M of reimbursable funds available each year.

Funds from other-than-federal sources. Two principal Private Funds, and several Non-Appropriated Fund Instrumentalities (NAFIs), are associated with the Naval Academy. The two private funds are non-governmental funds associated with the Naval Academy Athletic Association (NAAA) and the Naval Academy Gift and Museum Fund. Together these two private funds oversee approximately $40 million annually. The NAAA budget (associated with varsity athletics and the physical mission), the Naval Academy Gift and Museum Fund (private donations) and the Non-Appropriated Fund Instrumentalities (NAFIs)are not a part of the Cost Per Graduate summary. The NAAA is a 501(c)3 organization, responsible for supporting the 32 varsity sports fielded by the Academy; it raises the funds needed to sustain these intercollegiate sports through ticket income and other sources. The Superintendent allocates some Appropriated and Non-Appropriated funds to the NAAA to sustain the physical education curriculum for all midshipmen and to support a club and intramural sports program.

The Naval Academy Gift and Museum Fund is resourced through the fund-raising efforts of the Naval Academy Foundation with the support of the Naval Academy Alumni Association. This fund is not relied on for day-to-day operations, but is used to support Naval Academy Margin of Excellence projects related to midshipman academic, athletic and professional development. These funds amount to about $4-5M annually, exclusive of capital projects, and are relatively modest in comparison with other schools of our size. Because they define the Academy's academic, athletic, and professional Margins of Excellence beyond the core mission appropriations we receive, Gift Fund supported projects in particular are a focal point of Naval Academy strategic planning efforts.

Of the five Non-Appropriated Fund Instrumentalities (NAFIs), the Naval Academy Business Services Division (NABSD) is by far the largest. All together, the NABSD oversees about $42M in income annually. The NABSD manages all activities associated with USNA business activities such as the Midshipman Store, the Naval Academy Visitor Center, the Drydock Restaurant, the Naval Academy Club, and a variety of midshipman-related support activities including dry cleaning services, a cobbler shop, computer repair, barber and beauty shops and the like. The other NAFIs are the Midshipman Welfare Fund (for midshipman extra-curricular activities—about $3 million annually), the Midshipman Ration account (for disbursement of meal funds, based on a daily rate of $10.80 per midshipman), the Candidate Guidance Fund (to manage fees charged to prospective midshipman candidates attending the Naval Academy Summer Seminar, a week-long orientation program each June for rising high school seniors—about $500K each year), and the Naval Academy Prep School (NAPS) Battalion Activities Fund (which oversees the very modest funds associated with the Ship Store at NAPS).

Congress sets upper limits on numbers of midshipmen. The upper limit of the Naval Academy's enrollment is mandated by Congress. Year-to-year levels within that upper constraint are set by the Chief of Naval Personnel (CNP). The Naval Academy operates within these limits and seeks funding appropriate to the limits that have been set. From 1999 to 2010, in coordination with the CNP, USNA has increased the student population by over 14% (**Enclosure 4.04**). In fall 2010, enrollment stood at 4,552 midshipmen. Typically, there are between forty and fifty students from other nations enrolled at USNA for a four-year course of study. (There is a statutory limit of 60 foreign national students.) As noted below under **O&M,N Funding Shortfall**, the appropriated funds that provide the bulk of the USNA mission budget have not kept pace with this growth in the size of the Brigade of Midshipmen. There is, however, the possibility that the size of the Brigade may decrease in coming years.

As noted earlier, the O&M,N Core Mission funds are of highest relevance to the financial health and outlook of the Naval Academy and the quality of graduates it is providing to the Navy and Marine Corps. There are four issues that have recently exerted pressure on these funds. The first is that since 2004, control over facilities and maintenance funds has moved to the Commander, Navy Installations Command (CNIC). Second, appropriations have not kept up with increases in the cost of operating the Academy given even current staffing levels. Third, a steady increase in the mandated size of the Brigade over the last decade has occurred without a comparable increase in OM&N funds to cover additional faculty and staff positions and instruction related materials. Fourth, USNA's own internal financial management structure and processes related to the allocation of O&M,N funds and non-appropriated funds, on occasion, makes management of these funds complicated.

Commander, Navy Installations Command (CNIC).

As previously noted, in 2004, financing of USNA infrastructure and facility maintenance, operation and construction projects was placed under the Commander, Navy Installations Command (CNIC). The continuing funding line from CNIC has been robust—indeed, more robust than for virtually any other equivalent shore complex in the Navy. A number of significant infrastructure investments have taken place under this new arrangement including the new construction of Wesley Brown Field House and the current renovation of King Hall (the midshipman dining facility, funded through the 2009 American Recovery and Reinvestment Act) and Hubbard Hall (the men's and women's crew facility). In addition, CNIC funding has significantly reduced the risk of deferred maintenance of USNA facilities. As noted in Chapter Two, in response to one of the 2006 MSCHE recommendations, CNIC and the Naval Academy have a multi-year plan for the Restoration of our two oldest academic buildings, Rickover Hall and the Nimitz Library building and facility.

Although initially challenging, this arrangement resulted in a more transparent process for the execution of Naval Academy mission and facilities funds. With its creation, CNIC has generated a rigid, and intended, "silo" around infrastructure spending. That is, O&M,N infrastructure funds are not available to the Command for any other purposes and indeed are provided through a separate command authority.

As long as the facilities and mission funds were comingled, a shortfall in one account (e.g., mission) could be masked by reallocations from the other account (e.g., facilities). Once this was no longer possible, systemic shortfalls in mission funding became more apparent and, ultimately, resulted in the re-baselining of Naval Academy mission funding described below. This approach has led to more stable and more robust funding of Naval Academy facilities and maintenance requirements.

O&M,N Funding Shortfall

As shown in **Enclosure 4.05**, the fiscal year 2009 USNA Operating Budget used for planning purposes (pre-decisional) was $134.7M, and for fiscal year 2010 it was projected to be $133.1M, a $1.6M reduction from the 2009 budget. However, in the end, USNA was allocated $138M for FY 2010. Similarly, the planning figure for FY 2011 was essentially the same as that for FY2010 ($133.2M), yet as

of May 2011 the outlook for total FY2011 funding may be as high as $137.3M. In addition to such year-to-year and within-year fluctuations, which result in considerable uncertainty at the Academy, over the last ten years, the Navy's 1.5% inflater (the annual, base-budget inflation rate) has not kept pace with the cost of operating the Academy due to increased costs such as the Congressionally-approved annual cost of living allowances (COLA) for all USNA civilian staff and faculty; the need to recruit professors in STEM disciplines; the increased cost of living area in the Washington, DC metropolitan area; the steady increase in the size of the Brigade of Midshipmen (**Enclosure 4.04**); and the rising price of library serial subscriptions (electronic and paper journals, newspapers, etc.). As a result, the Academy's expenses have been driven up about 3.5% annually, which has created a cumulative budget shortfall. These circumstances have stimulated discussions with the Department of the Navy regarding a reset of the Academy's baseline budget, which is described below under the nest heading, *re-baselining*.

Re-baselining

The circumstances just described led to discussions with Navy leadership to "re-baseline" the Academy's Core Mission budget. With input from the Academy, Navy leadership plans a significant increase in the Academy's Core Mission budget for FY2012 and beyond. (Because these budget documents are *pre-decisional*, regrettably they cannot be included in this report. However, discussions with Navy leadership are encouraging and are being pursued in the most positive spirit of cooperation.) If approved, the new baseline will provide a firm funding figure around which to plan at the beginning of the fiscal year.

In addition to re-baselining the Academy's Core Mission budget appropriation, several other issues are addressed in the FY12 planning figures under discussion. One of the most significant issues is the imbalance between the number of civilian and military faculty that has occurred over the last several decades. The FY12 planning figures acknowledge the goal of re-establishing a 50:50, civilian:military faculty mix. The civilian/military imbalance has recently grown to over 60% civilian faculty members. Helpfully, the Marine Corps had agreed to augment its Table of Allowances for Marine officers at the Naval Academy by 21 additional officer instructors beyond the current level of 43. This action is expected to be completed by fiscal year 2015 and helps compensate for the additional number of USMC graduates being commissioned in each USNA graduating class since 2009.

Along with this readjustment in the faculty mix is a proposed stabilization of the resources available for annual faculty merit pay increases as outlined in the faculty pay model (**Enclosure 2.10**). In addition, the FY12 planning figures address the related need to reduce the reliance on part-time, adjunct faculty which has occurred due to the reduced number of military faculty. In recent semesters, adjunct instructors have made up about 12% of the total faculty FTE. This growing reliance on adjunct faculty—and the commensurate increase in the amount of the budget that is allocated to them —has constrained the Office of the Academic Dean and Provost funding for other academic-related activities at USNA.

The requested FY12 funding would also include additional funds for the instruction of technical majors related to the greater number of project based activities being included in the STEM curriculum; language, regional expertise and culture (LREC) initiatives; and cyber security studies to address the growing emphasis in this area on the part of the Navy and DOD.

If implemented at the level currently being discussed (as of May 2011), FY12 and future O&M,N allocations will alleviate much of the uncertainty over the Academy's Core Mission budget by providing adequate funding of labor and other critical instruction-related activities.

Internal Allocation of O&M,N Funds

Another financial management challenge is related to that portion of the O&M,N annual budget allocated to academic equipment such as computers and laboratory equipment. This spending is described as Investment Equipment (under the Academic Computer Center line 3, **Enclosures 4.01 and 4.02**) and is controlled by the Deputy for Instructional Technology Services. It has historically represented another

inflexible financial "silo." Departments are asked about equipment needs but they are not asked if they would like less equipment in order to support other, more pressing, issues, such as professional development and conference travel. The Faculty Senate Finance committee and USNA leadership are currently exploring alternative mechanisms for Investment Equipment spending.

Increased Transparency

As was described in considerable detail in the governance section of the 2005 Accreditation Self Study, the Naval Academy has multiple sources of oversight: financial, governance, accreditation, and the simple circumstance of being integrated into much larger administrative entities like the Department of the Navy and the Department of Defense. Each year the USNA Superintendent sends a *Managers' Internal Control Program (MICP) Certification Statement* to the Secretary of the Navy, certifying that "management controls are in place and operating effectively, and the objectives of the Federal Managers' Financial Integrity Act were achieved" (**Enclosure 4.06**). There are no audited financial statements in the Chapter Four appendix since the USNA appropriated budget is audited as part of the larger Navy and Department of Defense audit structure.

These multiple sources of funding for USNA and USNA-related activities raise both opportunities and risks. In particular, use of external funds to support the Naval Academy must meet strict regulations regarding the use of private funds by a government agency. An audit by the Office of the Naval Inspector General (IG) identified a variety of "financial irregularities" in 2009 that were inconsistent with the DON and DOD rules and regulations governing USNA financial management and expenditures. As a consequence of the Naval IG report, a variety of additional auditing teams visited USNA during the fall of 2010 and reviewed financial processes and statements. As a result of these audits, significant changes to financial processes have been implemented. In particular, new instructions have been issued on Gift Fund Expenditures (USNA Instruction 7000.4, dated 19 APR 2011), Non-Appropriated Fund Instrumentalities (USNA Instruction 7010.3, dated 1 MAR 2011), and Acceptance of Gifts (USNA Instruction 4001.5A, dated 14 OCT 2010).

The transition of the Naval Academy's appropriated funding to the Chief of Naval Personnel (CPN) has brought increased monitoring of USNA accounts, and the corresponding time demand on Comptroller staff is extremely high. While CNP is better resourced in this regard than our previous financial overseer, this transition has made aspects of an already complicated process increasingly intricate. As a result, there is a great need for enhanced training of all USNA managers who deal with resources, and perhaps a larger financial management staff more closely integrated into the Command, as well.

There are undoubtedly a number of opportunities to improve communication with USNA faculty and staff, and other stakeholders, as appropriate. Access to future planning materials and validated information regarding past spending (such as audits) allows stakeholders and faculty to evaluate the effectiveness of past practice and anticipate opportunities and risks in the future. Greater communication enhances the ability of stakeholders to assess the adequacy of funding levels and contribute to effective future planning. Recent events have reaffirmed the importance of sustained efforts to communicate financial regulations, processes and procedures and other information to all key Academy personnel.

There have been a number of positive developments regarding these recommendations. Throughout the fall semester, the Academic Dean and Provost's office circulated a number of extremely informative documents outlining budgetary issues and processes for current and future years. In October 2010, the Deputy for Finance/Chief Financial Officer met with the Faculty Senate Finance Committee to discuss general financial process issues and the need for supplementary funds to meet faculty travel needs. The Comptroller also met in October 2010 with faculty from the Middle States Periodic Review Report Committee for an open and detailed discussion regarding the financial information needed for the PRR Self-Study. Among academic departments, there have been a number of new initiatives to increase transparency in planning and the opportunity for faculty to contribute to financial allocations. Historically, the budget for an individual academic department has been determined by past allocations.

During the 2010 academic year, the Faculty Senate Finance Committee helped develop a new process whereby departments develop need-based budget requests for the coming year and receive feedback on that request from other departments within a division. Over the summer of 2010, these budgets were submitted to the Academic Dean and Provost for his consideration. This new process provides a detailed view of the activities funded within academic departments and helps the USNA administration identify underfunded activities.

This more transparent process, driven by input from individual departments, should also help to better articulate the need for funds and the impact of different funding scenarios. A clearer description of financial needs, academic and otherwise, can help establish a greater understanding of those needs among external funding sources and cultivate more support from those sources.

Conclusion

In recent years, there have been a number of positive developments with respect to financial planning within academic and other USNA departments. Due to increased communication and transparency with the Comptroller's office, there is a broader understanding of the challenges associated with financial planning and execution. There are also more avenues for input to the financial planning process. However, a number of recurring financial issues continue to challenge USNA leadership.

In particular, annual variability in O&M,N funding and recent uncertainty over previously established long-term financial plans have created an environment of financial unpredictability. Much of this variability is driven by external dynamics. Effective strategies for at least partially shaping these dynamics and hedging against unexpected changes in funding would undoubtedly further the USNA mission. As already noted, a number of innovative and important activities have been added to the Academy's portfolio, including a cyber-security infrastructure and curriculum, expanded science, technology, engineering and mathematics curricula, language and regional curricula and activities, and initiatives to strengthen the diversity of USNA's student population. These initiatives will be most successful when they are supported by a stable, adequate financial foundation.

Chapter Four Appendix
Enclosures

Enclosure 4.01
FY 2009 USNA CPG DATA AND MANPOWER COST REPORT
Summary: Cost Per Graduate "38-liner"

Enclosure 4.02
COST PER GRADUATE REPORT FY09
38 Line Detail

Enclosure 4.03
USNA IPEDS Data (2007 – 2009)

Enclosure 4.04
USNA Enrollments (1999-2010)

Enclosure 4.05
USNA Operating Budgets

Enclosure 4.06
Managers' Internal Control Program (MICP) Certification Statements