South Carolina Legislative Audit Council

LAC

Report to the General Assembly

June 2001

A Review of the Higher Education Performance Funding Process

LEGISLATIVE AUDIT COUNCIL
1331 Elmwood Ave., Suite 315
Columbia, SC 29201
(803) 253-7612 VOICE
(803) 253-7639 FAX

Authorized by §2-15-10 *et seq.* of the South Carolina Code of Laws, the Legislative Audit Council, created in 1975, reviews the operations of state agencies, investigates fiscal matters as required, and provides information to assist the General Assembly. Some audits are conducted at the request of groups of legislators who have questions about potential problems in state agencies or programs; other audits are performed as a result of statutory mandate.

The Legislative Audit Council is composed of five public members, one of whom must be a practicing certified or licensed public accountant and one of whom must be an attorney. In addition, four members of the General Assembly serve ex officio.

Audits by the Legislative Audit Council conform to generally accepted government auditing standards as set forth by the Comptroller General of the United States.

Copies of all LAC audits are available to the public at no charge.

A Review of the Higher Education Performance Funding Process
was conducted by the following audit team.

Audit Team

Assistant Director
Jane I. Thesing

Senior Auditor
Marcia Ashford Lindsay

Associate Auditor
Cynthia B. Piper

Typography
Candice H. Pou
Maribeth Rollings Werts

Senior Legal Counsel
Andrea Derrick Truitt

South Carolina Legislative Audit Council

LAC

Report to the General Assembly

A Review of the Higher Education Performance Funding Process

Contents

Contents

Synopsis

Members of the General Assembly requested that the Legislative Audit Council review the higher education performance funding process. We focused on the Commission on Higher Education's (CHE's) implementation of Act 359, enacted in 1996, which required the CHE to develop a funding formula based on performance. The act established 9 critical success factors and 37 indicators that could be used to measure an institution's performance.

- Although the law required the CHE to allocate all funds based on performance beginning in FY 99-00, only a small percentage of funding has been affected by performance scores. In FY 99-00 and FY 00-01, the years in which funding was to be based *entirely* on performance, the amount affected by performance scores was 3% each year.

- The law requiring appropriations for higher education to be based entirely on performance should be changed. If funding allocations had been based solely on performance, extreme fluctuations in funding could result. Funding for institutions fluctuated as much as 30%–40% annually in our simulated example of 100% performance funding.

- Beginning in FY 91-92 the CHE allocated some institutions a higher percentage of needed funds than others. In order to avoid some schools receiving less funding than they had in the previous year, CHE shifted a percentage of other institutions' funding to those with dropping enrollment. As a result, when Act 359 mandated that funding be based on performance, the institutions did not start on a level playing field.

- With performance funding, the CHE developed a new formula, the Mission Resource Requirements (MRR), to determine institutional needs. This formula is similar to the formula used previously by the CHE. A consultant study found the MRR to be a valid funding method, and also found that South Carolina institutions were generally funded at a lower level than their peer institutions.

- The CHE has complied with the law in developing and implementing performance measures. However, the current performance funding measures do not provide a comprehensive assessment of institutional quality. Reasons that the performance measurement system should not be used as the sole determinant of institutional funding include: changes and volatility of the system, problems in measurement, the narrow focus of the indicators, and the use of some indicators that may be inappropriate for some institutions.

- Performance funding has had little effect on the elimination of waste and duplication in higher education. The CHE has promulgated regulations for the reduction, expansion, consolidation, or closure of an institution as a result of institutional performance, but the possibility of this occurrence is remote. Institutions report their internal efforts to eliminate duplication and waste in both academic and administrative areas.

- The CHE has implemented a data verification process that provides improved control over information used to evaluate performance. However, this process could be strengthened if the CHE implemented a policy to correct any misallocation of funds that occurred due to data errors.

- We found no material problems with the performance improvement grants awarded by the CHE to eligible institutions. However, CHE should follow up and review expenditures and results of the grants.

Introduction and Background

Audit Objectives

Members of the General Assembly requested the Legislative Audit Council to review the higher education performance funding process. The objectives of this review are listed below.

- Review overall funding for higher education and determine the process by which funds have been allocated to institutions.

- Determine how the Commission on Higher Education has modified the way it allocates funds to institutions in response to the requirements of Act 359 and what portion of funds has been allocated based on performance.

- Review the standards and measures developed by the Commission on Higher Education to assess the achievements of the institutions to determine whether they comply with the law and provide meaningful assessments of institutional quality.

- Review the relationship between performance funding and the elimination of duplication and waste in the state's system for higher education.

For discussion of the audit scope and methodology, see Appendix A. This audit was conducted in compliance with generally accepted government auditing standards.

Funding for Higher Education

The Commission on Higher Education (CHE) consists of 14 members appointed by the Governor. There is one at-large member to serve as chair, one representative from each of the six Congressional districts, three members appointed from the state at-large, three representatives of the public colleges and universities, and one representative of the independent colleges and universities of South Carolina. Two of the CHE's standing committees, the committee on finance and facilities and the committee on planning, assessment, and performance funding, have been involved in the performance funding process.

According to S.C. Code §59-103-35, each institution of higher education must annually submit a budget request to the Commission on Higher Education. The CHE prepares a consolidated request and allocation plan for the General Assembly and when the budget process is complete, allocates state funding to the individual institutions.

CHE has allocated state appropriations to the state's 33 colleges and universities primarily on the basis of a funding formula. Prior to the passage of Act 359 in 1996, the CHE used a 26-step funding formula. The formula used comprehensive data about various components of each institution, such as enrollment, faculty, and campus facilities, to determine the amount needed to carry out its mission.

Act 359 required the CHE to develop a funding formula that would be based on performance. The act established nine critical success factors (see below) and 37 indicators that could be used to measure an institution's performance. In FY 97-98, the CHE began to implement a new formula, the Mission Resource Requirements (MRR), to estimate each institution's need for funding. At this time, the CHE began allocating some state funding for higher education based on performance, as determined by the scores institutions received on performance indicators defined by the CHE. Table 1.1 shows the total amount appropriated to higher education institutions for operations for FY 96-97 through FY 00-01.

CRITICAL SUCCESS FACTORS FOR HIGHER EDUCATION

(1) Mission Focus.
(2) Quality of Faculty.
(3) Classroom Quality.
(4) Institutional Cooperation and Collaboration.
(5) Administrative Efficiency.
(6) Entrance Requirements.
(7) Graduates' Achievements.
(8) User-friendliness of the Institution.
(9) Research Funding.

Source: S.C. Code §59-103-30(A)

Table 1.1: State Appropriations for Higher Education

YEAR	AMOUNT*	PERCENT INCREASE
FY 96-97	$642,406,620	4.6%
FY 97-98	$674,941,540	5.1%
FY 98-99	$705,145,286	4.5%
FY 99-00	$754,688,747	7.0%
FY 00-01	$802,499,188	6.3%

* Appropriations for operations. Does not include capital improvement funds or unique costs (see below-the-line items, p. 5).

Source: CHE.

Percentage of Need Funded

As discussed above, the CHE calculates its budget request for the institutions of higher education by using a funding formula. The General Assembly has not appropriated the full amount requested by the CHE for several years. Based on the funding formula, the recent level of funding for higher education has averaged around 75% of the amount requested (see Table 1.2).

Table 1.2 represents the overall percentage of the CHE's request that has been funded; individual institutions may receive less or more than this percentage. Differing levels of funding for different institutions came about because the commission's allocations to certain institutions were in excess of what the formula called for. When the CHE gave more funds to some institutions, others received less than their share of funding formula dollars (see p. 10).

Table 1.2: Higher Education Percent Funding

YEAR	NEED DETERMINED*	STATE APPROPRIATION	PERCENT FUNDED
FY 96-97	$889,192,158	$642,406,620	72.25%
FY 97-98	$912,420,568	$674,941,540	73.97%
FY 98-99	$957,995,896	$705,145,286	73.61%
FY 99-00	$1,004,209,087	$754,688,746	75.15%
FY 00-01	$1,041,513,843	$802,499,188	77.05%

* For FY 97-98 and FY 98-99, both the old formula and the MRR were used to calculate portions of needed funding. For FY 99-00 and FY 00-01, the MRR was used to determine need.

Regional Funding Comparisons

We obtained comparative statistics on state funding for higher education from the Southern Regional Education Board (SREB). Table 1.3 compares the level of state funding per full-time equivalent (FTE) student in different states in the region.

Table 1.3: Appropriations Per FTE Student in SREB States FY 99-00

4-Year Institutions	
North Carolina	$7,862
Georgia	$7,562
Florida	$7,520
Maryland	$7,054
Mississippi	$6,321
Texas	$6,133
SREB States Average*	**$6,037**
Virginia	$5,766
Arkansas	$5,618
Delaware	$5,503
South Carolina	**$5,367**
Tennessee	$5,330
Oklahoma	$5,204
Kentucky	$5,025
Alabama	$4,871
West Virginia	$3,954
Louisiana	$3,803

2-Year Institutions	
North Carolina	$5,201
Georgia	$5,171
Maryland	$4,947
Arkansas	$4,844
Mississippi	$4,791
Texas	$4,546
Oklahoma	$4,308
SREB States Average*	**$4,124**
South Carolina	**$3,779**
Tennessee	$3,692
West Virginia	$3,590
Virginia	$3,560
Alabama	$3,440
Florida	$3,387
Kentucky	$3,170
Louisiana	$3,002
Delaware	$2,132

*Overall average (not an average of state averages).

Source: Southern Regional Education Board.

Generally, South Carolina is below the regional average in state support of higher education. However, funding comparisons should be used with caution, due to the different structures of higher education and the different types and numbers of institutions in different states.

Below-the-Line Items

In addition to costs accounted for in the funding formula, the CHE has recognized that there are certain additional costs that are unique to one or a small number of institutions. For example, the Small Business Development Center (SBDC) on the University of South Carolina – Columbia campus offers management and technical assistance to small businesses. The costs of the SBDC are not provided for in the funding formula. The CHE reviews and recommends to the General Assembly funding for these unique costs, which are called below-the-line items. The amount appropriated for below-the-line items for each of the past five years is shown in Table 1.4.

Table 1.4: State Appropriations for Below-the-Line Items

YEAR	AMOUNT	PERCENT OF APPROPRIATIONS
FY 96-97	$9,733,113	1.5%
FY 97-98	$13,838,511	2.0%
FY 98-99	$12,663,264	1.8%
FY 99-00	$17,938,490	2.3%
FY 00-01	$16,843,805	2.1%

Source: CHE

Although S.C. Code §59-103-35 requires institutions of higher education to request state funding through the Commission on Higher Education, they do not always follow this process. According to officials, sometimes the institutions request funding directly from the General Assembly, and other times the General Assembly makes appropriations that institutions have not requested. For example, the appropriations listed in Table 1.5 were not recommended by the CHE.

Table 1.5: Examples of Below-the-Line Items Not Recommended by the CHE

YEAR	INSTITUTION	PURPOSE	AMOUNT
FY 96-97	The Citadel	Women's Leadership Initiative	$1,400,000
FY 97-98	S.C. State University	1890 Leadership Institute	$100,000
FY 98-99	College of Charleston	Youth Race Incentive	$50,000
FY 99-00	Lander University	Academic Initiative	$500,000
FY 00-01	Coastal Carolina University	Art Department Accreditation	$75,000

According to CHE officials, when institutions request and/or receive appropriations without CHE review, the funding process for higher education is undermined. When there is not enough funding to meet all needs, the CHE's review process helps to ensure that educational priorities are maintained.

Recommendation

1. Institutions of higher education should comply with S.C. Code §59-103-35 and submit all requests for funding to the Commission on Higher Education.

Allocation of Funds

We reviewed the Commission on Higher Education=s allocations of state funding to colleges and universities since the passage of Act 359 in 1996. We found that, although the law required the CHE to allocate all funds based on performance beginning in FY 99-00, only a small percentage of funding has been affected by performance. We concluded the law should be changed to eliminate the requirement that funding be based entirely on performance. Also, we found that when performance funding began, the institutions did not start on a level playing field; they had not been equally funded based on the previous needs formula, and funding parity did not exist.

Performance Funding

The CHE is required by statute to allocate funds for institutions based on their performance. Act 359, which became effective July 1, 1996, provided for a phase-in period. S.C. Code §59-103-45(4)(b) mandated the CHE to develop a funding formula based *in part* on the achievement of the standards set for the performance indicators. For FY 97-98 and FY 98-99, the law also required that the base appropriations for institutions be no less than the appropriations for FY 96-97.

Additionally, S.C. Code §59-103-45 (4)(d) required the commission to develop a formula based *entirely* on an institution=s achievement of these standards, beginning July 1, 1999. The law identifies the success criteria and performance indicators (see p. 18) to measure institutional performance. However, the CHE has not allocated funds based entirely on performance (see Table 2.1).

Table 2.1: Funds Affected by Performance Scores

YEAR	STATE APPROPRIATIONS	AMOUNT AFFECTED BY PERFORMANCE	PERCENTAGE AFFECTED BY PERFORMANCE
FY 97-98	$674,941,540	$4,625,003	1%
FY 98-99*	$705,145,286	$265,668,818	38%
FY 99-00	$754,688,747	$25,794,241	3%
FY 00-01	$802,499,188	$27,080,920	3%

* Appropriation act proviso 5A.26 required that $250 million be allocated using the performance indicators this year.

As shown in Table 2.1, the amount of funding affected by the institutions= scores on performance indicators has not been significant. In the second phase-in year, FY 98-99, appropriations act proviso 5A.26 mandated that the CHE distribute $250 million using the performance indicators. In that year, performance scores affected a total of almost $266 million. In FY 99-00 and FY 00-01, the years in which funding was to be based *entirely* on performance, the amount affected by performance scores was 3% each year.

CHE staff stated that they have complied with the law requiring 100% performance funding because, in order to qualify for its base appropriation (appropriation from the previous year), an institution must score in the Aachieves@ range (see p. 19). If the institution received a score of Adoes not achieve@ or Asubstantially does not achieve,@ its base budget would be reduced by 3% or 5%, respectively. However, as of April 2001, no school had received a score lower than Aachieves.@ Also, even if a school did receive Adoes not achieve@ or lower, the effect on its appropriation would be at most 5%, leaving 95% to be allocated not by performance, but according to institutional needs.

The law requiring appropriations for higher education to be based entirely on performance should be changed.

We concluded that the law requiring appropriations for higher education to be based entirely on performance should be changed. There are two primary reasons why an institution=s entire funding should not be based on the performance indicators:

- The science of performance measurement has not advanced to the degree that the institutional scores have provided valid comprehensive assessments of institutional quality (see p. 17).

- Allocations based solely on performance scores could result in extreme fluctuations in funding.

If the funding formula took no account of institutional needs, but was based solely on a performance score, the institution with the highest score would get the most funding. For example, in FY 00-01, USC–Sumter should have been allocated more funds than USC–Columbia because it had a higher performance score.

Even with the use of a formula where institutional needs are considered in addition to performance scores, wide fluctuations in funding could result. We multiplied the CHE=s determinations of institutional need (the MRR, see p. 13) by the relevant performance scores to provide a simulated example of 100% performance funding (see Table 2.2) for FY 99-00 and FY 00-01. Funding for some institutions fluctuated as much as 30%–40% annually using this methodology.

Table 2.2: Simulated Example of Allocations Based Solely on Performance

Institution	FY 98-99 Actual Appropriation	FY 99-00 Total Performance Allocation	Percent Change 98-99 -- 99-00*	FY 00-01 Total Performance Allocation	Percent Change 99-00 -- 00-01
Clemson University	$97,815,027	$100,345,109	2.59%	$98,844,908	-1.5%
USC-Columbia	$169,462,312	$183,611,217	8.35%	$170,740,137	-7.0%
Medical University of South Carolina	$95,784,253	$82,462,656	-13.91%	$97,340,607	18.0%
The Citadel	$15,548,741	$12,210,794	-21.47%	$13,211,794	8.2%
Coastal Carolina University	$12,430,306	$12,478,682	0.39%	$14,922,292	19.6%
College of Charleston	$28,429,609	$28,241,875	-0.66%	$32,906,083	16.5%
Francis Marion University	$14,675,471	$14,104,610	-3.89%	$14,766,546	4.7%
Lander University	$9,922,861	$10,920,464	10.05%	$10,582,755	-3.1%
SC State University	$22,874,220	$19,201,924	-16.05%	$21,503,595	12.0%
USC - Aiken	$9,947,507	$12,642,227	27.09%	$14,861,672	17.6%
USC - Spartanburg	$11,968,844	$12,898,608	7.77%	$17,948,618	39.2%
Winthrop University	$21,854,944	$23,641,435	8.17%	$27,658,768	17.0%
USC - Beaufort	$2,076,475	$2,629,940	26.65%	$2,582,229	-1.8%
USC - Lancaster	$2,796,463	$2,638,603	-5.64%	$3,084,599	16.9%
USC - Salkehatchie	$2,229,364	$2,298,924	3.12%	$2,725,059	18.5%
USC - Sumter	$4,070,316	$4,267,533	4.85%	$4,755,114	11.4%
USC - Union	$1,069,822	$906,685	-15.25%	$1,066,456	17.6%
Aiken Technical College	$5,686,057	$5,890,246	3.59%	$7,151,656	21.4%
Central Carolina Technical College	$6,526,322	$9,322,108	42.84%	$8,608,769	-7.7%
Northeastern Technical College	$2,789,747	$2,832,999	1.55%	$3,260,626	15.1%
Denmark Technical College	$3,573,861	$3,154,371	-11.74%	$3,852,272	22.1%
Florence-Darlington Technical College	$8,907,481	$12,713,659	42.73%	$13,653,681	7.4%
Greenville Technical College	$20,494,236	$30,154,917	47.14%	$35,136,860	16.5%
Horry-Georgetown Technical College	$8,485,715	$10,682,722	25.89%	$12,708,255	19.0%
Midlands Technical College	$21,445,695	$30,256,552	41.08%	$35,093,364	16.0%
Orangeburg-Calhoun Technical College	$6,131,435	$7,767,424	26.68%	$7,531,252	-3.0%
Piedmont Technical College	$8,347,845	$10,112,011	21.13%	$13,843,812	36.9%
Spartanburg Technical College	$7,667,923	$10,463,935	36.46%	$12,367,598	18.2%
Technical College of the Lowcountry	$4,297,527	$4,666,586	8.59%	$4,627,034	-0.8%
Tri-County Technical College	$8,671,694	$11,874,870	36.94%	$11,716,875	-1.3%
Trident Technical College	$20,578,228	$28,882,136	40.35%	$28,517,712	-1.3%
Williamsburg Technical College	$2,004,341	$1,728,110	-13.78%	$1,988,290	15.1%
York Technical College	$8,600,147	$9,858,192	14.63%	$13,253,009	34.4%

* Funding based solely on the need (MRR) and performance scores. Percent change due to institutions' different levels of parity (see p. 10) as well as performance. See Appendix A for explanation of our methodology.

The CHE=s allocations based on performance have been in line with other states. We reviewed information about other states that have implemented performance funding for higher education. In a 1997 national report, nine states reported they allocated between less than 1% and 3.4% of their funding based on performance. A survey conducted by the Nelson A. Rockefeller Institute of Government stated that as of 2000, 17 states had performance funding for all or part of their state=s higher education system. This survey also stated that:

> . . . too much funding [based on performance] can have the detrimental effect of producing budget instability. The early effort in South Carolina to base all funding on performance presents a classic example of this flaw.

If South Carolina continued to allocate a portion of funds based on performance scores, institutions would have a financial incentive to improve performance, without having all funds subject to an imperfect system of measurement that could adversely affect their ability to plan for effective operations.

Recommendation

2. The General Assembly should consider amending S.C. Code §59-103-45 to require the CHE to use a funding formula based in part on an institution=s achievement of the standards set for performance indicators.

Parity in Funding

Beginning in FY 91-92, the Commission on Higher Education allocated some institutions a higher percentage of needed funds than others. As a result, when Act 359 mandated that funding be based on performance, beginning in FY 97-98, the institutions did not start on a level playing field.

Prior to FY 91-92, appropriations act provisos required that all colleges and universities receive an equivalent percentage of formula funding. Appropriations act proviso 15.8 in FY 90-91 states:

> The Commission on Higher Education shall allocate funds appropriated to colleges and universities and The State Board for Technical and Comprehensive Education to insure that all institutions shall receive equivalent percentages of formula funding.

For example, if the General Assembly funded CHE’s requested budget for all the institutions at 85%, each institution would receive 85% of its requested funding. However, in FY 91-92 this provision was eliminated from the appropriations act, and CHE’s allocation for that year gave a higher percentage funding to some institutions than to others.

According to CHE staff, this change occurred because some institutions' enrollments began to drop and funding for higher education was limited. Enrollment was the primary variable that affected how much funding was allocated to each institution. In order to avoid some schools receiving less funding than they had in the previous year, CHE shifted a percentage of other schools' funding to those with dropping enrollment. CHE referred to this arrangement as a "hold harmless" or "safety net" agreement. Although, according to officials, the safety net was intended to be temporary, this funding pattern continued for at least the next four years. The technical colleges and others with high growth in enrollment were funded at a lower percentage of need, as determined by the funding formula, than institutions with stable or declining enrollment.

The CHE planned to address the problem in funding parity. In January 1995, the commission approved a plan to allocate some state funds to address inequities each year until the problem was corrected. However, with the passage of Act 359, the CHE was required by law to implement a new funding formula that would be based on performance. Beginning in FY 97-98, the CHE began to implement the new formula. At that time, the institutions were not funded at an equal percentage of need (see Table 2.3).

Table 2.3: Percentage of Need Funded FY 97-98

Institution	Percentage Funded
USC – Union	85.32%
S.C. State University	80.67%
Winthrop University	77.76%
USC – Columbia	77.70%
USC – Sumter	76.55%
Francis Marion University	76.51%
The Citadel	76.49%
Clemson University	76.28%
USC – Lancaster	75.13%
Medical University of South Carolina	73.38%
Coastal Carolina University	73.15%
USC – Spartanburg	72.84%
USC – Beaufort	71.72%
Lander University	71.71%
USC – Salkehatchie	71.43%
State Board for Technical & Comprehensive Education	70.94%*
USC – Aiken	68.69%
College of Charleston	67.87%

* Average of all technical colleges.
Source: CHE.

The lack of parity in funding has continued to concern the CHE and the higher education institutions. Although beginning in July 1999 state law required all funding to be based on performance, that year the CHE allocated $10 million to the seven institutions whose enrollment increases had not been recognized in previous funding allocations. The majority (63%) of this money was allocated to technical colleges. However, funding discrepancies remained. According to CHE staff, it would take approximately $56 million to bring the institutions into parity, based on need. Table 2.4 shows the percentage funded for each institution as of FY 00-01.

Table 2.4: Percentage of Need Funded FY 00-01

INSTITUTION	PERCENTAGE FUNDED
The Citadel	94.53%
USC – Sumter	87.76%
S.C. State University	85.70%
USC – Columbia	81.52%
Clemson University	81.05%
Francis Marion University	80.55%
USC – Union	80.41%
Winthrop University	79.03%
Medical University of South Carolina	78.80%
Lander University	77.45%
Denmark Technical College	74.49%
College of Charleston	73.96%
USC – Lancaster	71.63%
Coastal Carolina University	71.34%
USC – Aiken	70.67%
Technical College of the Lowcountry	69.49%
USC – Beaufort	68.33%
USC – Salkehatchie	68.25%
USC – Spartanburg	65.85%
Midlands Technical College	62.10%
Orangeburg-Calhoun Technical College	61.49%
Central Carolina Technical College	61.32%
York Technical College	61.18%
Trident Technical College	61.09%
Spartanburg Technical College	60.94%
Greenville Technical College	60.60%
Horry-Georgetown Technical College	60.16%
Tri-County Technical College	59.90%
Aiken Technical College	59.88%
Williamsburg Technical College	59.73%
Piedmont Technical College	59.64%
Northeastern Technical College (Chesterfield – Marlboro Tech.)	58.82%
Florence-Darlington Technical College	58.36%

Source: CHE.

Funding by performance, as mandated by Act 359, would also result in a lack of parity, because better-performing schools would get more funds that were not based on need. However, we found no evidence that the General Assembly intended that the CHE shift funds from schools with increasing enrollment to schools with stable or declining enrollment. State funding for higher education should reflect the intent of the General Assembly. If the General Assembly intended that institutions have the same starting point for allocations based on performance, funds should be allocated to correct previous disparities. Gradual phase-ins are needed to reduce disruptions based on sudden shifts of funds.

Recommendation

3. The General Assembly should consider requiring the Commission on Higher Education to phase in the allocation of funds necessary to achieve parity in funding based on need.

Formula to Determine Needs

The Mission Resource Requirements (MRR) formula has ten steps (see Table 2.5). During the implementation of performance funding, the commission used a combination of the old funding formula and the MRR for the first two years. Since FY 99-00, the MRR has been the sole funding formula used in determining need.

Table 2.5: Mission Resource Requirements Funding Formula, Needs Determined for FY 00-01

STEP	FUNDING AREA	AMOUNT
1	Instruction	$765,927,196
2	Research	57,799,673
3	Public Service	18,958,205
4	Libraries	61,119,890
5	Student Services	109,531,161
6	Physical Plant	126,831,805
7	Administration	299,106,168
8	**Subtotal**	**$1,439,274,098**
9	Revenue Deduction	- 395,842,576
10	**TOTAL EDUCATION AND GENERAL**	**$1,043,431,522**

Source: CHE.

Instructional costs (Step 1) is the major component of the MRR. Projected costs are determined by using detailed enrollment data to project the number and types of classes and faculty needed for the coming year. Estimated salary costs are determined by using averages at peer institutions with a factor for benefits. Once the total needs are determined, tuition collected by the institutions (Step 9 - revenue deduction) is subtracted. This results in the CHE=s determination of the appropriate state funding to meet institutions= fiscal needs.

The MRR is similar to the previous funding formula, but results in greater fiscal needs. Although the previous formula had 26 steps, CHE officials stated that it was very similar. The fiscal needs for research, public service, and physical plant are determined exactly as they were under the old formula. According to CHE staff, the main factors that increase the need as determined by the MRR are the use of national instead of regional faculty salary data and the use of a standard 26% for fringe benefits rather than the actual fringe benefits used by the previous formula.

In 1999, CHE contracted with a higher education consultant, MGT of America, to validate the MRR. The consultant=s contract was procured by the Budget and Control Board using the competitive request for proposal process.

Although MGT concluded that the MRR was a valid funding method, the consultant=s report made several recommendations to Aprovide a more accurate reflection of the needs of higher education in South Carolina.@ MGT also found that South Carolina institutions were generally funded at a lower level than their peer institutions.

In February 2001, the CHE voted to implement six of MGT=s nine recommendations. All of these recommendations, except one, will increase the estimated need for funding. The most significant effect results from allowing institutions to keep more tuition and fees collected instead of having these revenues subtracted from the need determination. Table 2.6 outlines the approved recommendations.

Table 2.6: Fiscal Impact of Consultant's Recommendations Approved by the CHE

Nature of Recommendation	Affected Step of MRR	Estimated Fiscal Impact Increased Needs
Deduct no more than 100% of actual graduate student revenues	Step 9	$59,338,435
Index targeted revenues for resident students to the percent of the MRR that is funded, and permit institutions to retain any amounts that would provide funding up to 100%	Step 9	$54,750,161
Use student headcount data instead of FTE students for all calculations for libraries and student services	Steps 4 and 5	$6,599,165
Introduce economies of scale factors for libraries and physical plant	Steps 4 and 6	$1,448,294
Permit institutions to retain first 10% of revenues over target revenues for resident students	Step 9	$1,124,952
Require consistent reporting of certain revenues and expenditures on the IPEDS finance surveys	N/A	No fiscal impact.

Source: CHE.

According to CHE staff, the estimated impacts of each recommendation cannot be added cumulatively because they do not stand alone. Since the different steps are related to one another, the director of finance estimated that the total fiscal impact of all of these recommendations will be approximately $150 million.

MGT also recommended changing the student/faculty ratios used in the instruction step (Step 1) to determine how many faculty are needed. The consultant recommended lowering the student/faculty ratios at the undergraduate levels for the two-year, teaching, and research sectors so that the ratios are the same as those for the technical college sector. This recommendation was deferred to allow CHE staff time to conduct additional research. This change, if implemented, was projected to have a fiscal impact of $39,784,808 in increased need.

The CHE voted to table or defer two additional MGT recommendations:

- To provide additional fee waivers for the use of colleges and universities.

- To introduce legislation to remove the requirement that public colleges and universities pay sales tax.

Neither of these recommendations was approved because of concern about the state's current economic situation.

Measuring Performance

Indicators of Quality

Act 359 [S.C. Code §59-103-45 (4)(a)] mandated that the Commission on Higher Education develop standards for determining how well an institution has met or achieved the performance indicators established in the statute. The CHE was also to develop ways to measure the achievement of particular institutions. Beginning in FY 99-00, the CHE's funding allocations were to be based entirely on the institutions' achievement of the standards set for the performance indicators.

We found that the CHE has complied with the law in developing and implementing performance measures. However, the current performance funding measures do not provide a comprehensive assessment of institutional quality. Although the CHE has implemented changes each year to improve the measurement system, there are several reasons why the system should not be used as the sole determinant of institutional funding:

- Changes and volatility in the system.
- Problems in measurement.
- Narrow focus of indicators.
- Applicability of indicators.

Changes and Volatility

The changes and volatility in the CHE's measurement system hinder a meaningful year-to-year assessment. With the passage of Act 359, the CHE was charged with evaluating the quality of public higher education institutions in South Carolina. The legislation lists 9 critical success factors and 37 indicators (see p. 18) which can be used to measure the success factors. The indicators used by the CHE have changed significantly each year. CHE phased in the use of all 37 indicators (see Table 3.1).

Table 3.1: Performance Indicators Used by Year

Year	Number of Indicators Used
FY 96-97	14
FY 97-98	22
FY 98-99	37
FY 99-00	37
FY 00-01	37

Table 3.2: Performance Indicators Enumerated in S.C. Code §59-103-30

Critical Success Factor	Performance Indicator
1 Mission Focus	a) Expenditure of funds to achieve institutional mission b) ***Curricula offered to achieve mission*** c) ***Approval of a mission statement*** d) ***Adoption of a strategic plan to support the mission statement*** e) ***Attainment of goals of the strategic plan***
2 Quality of Faculty	a) ***Academic and other credentials of professors and instructors*** b) Performance review system for faculty to include student and peer evaluations c) Post-tenure review for tenured faculty d) ***Compensation of faculty*** e) Availability of faculty to students outside the classroom f) Community and public service activities of faculty for which no extra compensation is paid
3 Classroom Quality	a) Class sizes and student/teacher ratios b) Number of credit hours taught by faculty c) Ratio of full-time faculty as compared to other full-time employees d) ***Accreditation of degree-granting programs*** e) ***Institutional emphasis on quality teacher education and reform***
4 Institutional Cooperation and Collaboration	a) ***Sharing and use of technology, programs, equipment, supplies, and source matter experts within the institution, with other institutions, and with the business community*** b) ***Cooperation and collaboration with private industry***
5 Administrative Efficiency	a) ***Percentage of administrative costs as compared to academic costs*** b) Use of best management practices c) Elimination of unjustified duplication of and waste in administrative and academic programs d) Amount of general overhead costs
6 Entrance Requirements	a) ***SAT and ACT scores of student body*** b) ***High school class standing, grade point averages, and activities of student body*** c) Post-secondary nonacademic achievements of student body d) Priority on enrolling in-state residents
7 Graduates' Achievements	a) ***Graduation rate*** b) ***Employment rate for graduates*** c) ***Employer feedback on graduates who were employed or not employed*** d) ***Scores of graduates on post-undergraduate professional, graduate, or employment-related examinations and certification tests*** e) ***Number of graduates who continued their education*** f) Credit hours earned of graduates
8 User-Friendliness	a) Transferability of credits to and from the institution b) Continuing education programs for graduates and others c) ***Accessibility to the institution of all citizens of the State***
9 Research Funding	a) ***Financial support for reform in teacher education*** b) ***Amount of public and private sector grants***

Note: ***Highlighted*** indicators to be scored in FY 01-02 in one or more sectors.

Although all of the indicators have been used, not all have been scored. The number of indicators scored has changed each year as not all indicators lend themselves to measurement (see p. 20). Many indicators that are not scored are judged as "yes/no" or "compliance" indicators. Being in compliance does not improve an institution's score; however, non-compliance may lower the score. The CHE has also created sub-measures to calculate a score for some indicators. In FY 99-00 the CHE used 71 measures, including sub-measures.

The scoring process has also undergone changes. In FY 96-97 and FY 97-98, a six-point scale was used. Institutions received a numeric score on a 100-point scale. Since FY 98-99, institutions have been scored on a three-point scale. Institutional scores on individual indicators are averaged to place the school in one of five categories (see Table 3.3). As of April 2001, all institutions have always scored in either the "achieves" or "exceeds" categories.

Table 3.3: Performance Categories

Averaged Score Range	Performance Category
2.85 – 3.00	Substantially Exceeds Standards
2.60 – 2.84	Exceeds Standards
2.00 – 2.59	Achieves Standards
1.45 – 1.99	Does Not Achieve Standards
1.00 – 1.44	Substantially Does Not Achieve Standards

Source: CHE.

Another change has been in the standards or benchmarks for each institution. In past years, institutions could set their own benchmarks with the approval of CHE. That is, Francis Marion could have a different standard for SAT scores of entering freshmen than Winthrop. As of FY 00-01, the CHE has set uniform standards for sectors (see p. 22) in collaboration with institutions. According to CHE staff, the uniform standards were appropriate to ensure that benchmarks were not set at artificially low levels.

We concluded that the changes by the CHE have generally been positive; however, the constant changes have hindered the use of the system as a consistent measure of institutional quality. For example, all 37 indicators have been used in 2 of the completed scoring cycles. In these cycles, an individual institution's scores varied by as much as 16 percentage points.

Changes for FY 01-02

The CHE has approved additional changes to the measures for FY 01-02. The changes would include reducing the number of scored indicators. Most of the proposed indicators can be quantified. The CHE would continue to monitor all indicators. As of May 2001, the CHE had not determined the level of reporting required from institutions. The indicators that CHE will score include at least one measure for each of the nine critical success factors. However, the CHE could reinstate other indicators at any time; it seems likely that changes in the system will continue.

Problems in Measurement

S.C. Code §59-103-30(C) requires that when the CHE applies "the critical success factors . . . , [it] is required to use objective, measurable criteria." However, some indicators cannot be easily measured or quantified (see Table 3.4). Measures should be quantified or they may be subjective.

Table 3.4: Indicators Not Easily Measured

INDICATOR	DESCRIPTION
2F	Community and public service activities of faculty for which no extra compensation is paid.
4A/B	Sharing and use of technology, programs, equipment, supplies, and source matter experts within the institution, with other institutions, and with the business community.
5C	Elimination of unjustified duplication of and waste in administrative and academic programs.
7C	Employer feedback on graduates who were employed and not employed.
6C	Post-secondary non-academic achievements of student body.

Narrow Focus of Indicators

The CHE has selected the indicators that will be scored in the coming year. The number of indicators used in any one sector will not exceed 14. They were chosen based on (1) a consultant's report, (2) institutional input, and (3) whether they can be quantified. However, the reduction in the number of indicators results in measures that may be too narrow. Specific examples are as follows:

- For the critical success factor, *Classroom Quality*, one of the two measures used by the CHE is "institutional emphasis on quality teacher education and reform." This measure is specific to a teacher education program and not to classroom quality in general. Another indicator, the number of credit hours taught by faculty, would be a more universal measure, but this indicator will not be scored.

- The critical success factor, *Institutional Cooperation and Collaboration*, will be assessed solely by a single quantifiable measure. This indicator requires every school in a sector (see p. 22) to work on a common goal. For example, the teaching sector will pursue a measure focusing on the representation of business, community, and public schools on academic program advisory boards. By narrowing this indicator to one very specific measure, the true volume of cooperation and collaboration may not be captured. However, according to CHE staff, this measure is not permanent and will change over time to another area of focus.

- The critical success factor, *User Friendliness of the Institution*, is measured solely by the indicator "accessibility to the institution of all citizens of the state," and this indicator is measured only by the percent of racial minority enrollment and faculty at the school.

Though these measures are important in determining quality, they are not inclusive and do not provide the comprehensive assessment needed if an institution's entire funding is to be based on the measures. CHE staff recognize that it is difficult to balance the need to have specific and objective measures with the need to be comprehensive in the assessment of quality.

Applicability of Indicators

Section 59-103-15(B) of the S.C. Code of Laws groups South Carolina public higher education institutions into four categories commonly called sectors (see Table 3.5).

Table 3.5: Institutions by Sector

RESEARCH INSTITUTIONS (RESEARCH SECTOR)
Clemson University
Medical University of South Carolina
University of South Carolina-Columbia
FOUR-YEAR COLLEGES AND UNIVERSITIES (TEACHING SECTOR)
The Citadel
Coastal Carolina University
College of Charleston
Francis Marion University
Lander University
South Carolina State University
USC – Aiken
USC – Spartanburg
Winthrop University
TWO-YEAR BRANCHES OF THE UNIVERSITY OF SOUTH CAROLINA (REGIONAL SECTOR)
USC – Beaufort
USC – Lancaster
USC – Salkehatchie
USC – Sumter
USC – Union
TECHNICAL AND COMPREHENSIVE EDUCATION SYSTEM (TECHNICAL COLLEGES)
Aiken Technical College
Central Carolina Technical College
Northeastern Technical College
Denmark Technical College
Florence-Darlington Technical College
Greenville Technical College
Horry-Georgetown Technical College
Midlands Technical College
Orangeburg-Calhoun Technical College
Piedmont Technical College
Spartanburg Technical College
Technical College of the Lowcountry
Tri-County Technical College
Trident Technical College
Williamsburg Technical College
York Technical College

Source: CHE.

Section 59-103-30 (D) of the S.C. Code of Laws requires that "critical success factors developed and used for the purpose of funding recommendations shall be those which are directly related to the missions of the particular type of institution as outlined in section 59-103-15 (B). . . ." Although the number of indicators varies by sector, schools within the same sector are generally evaluated by the same measures. This "one size fits all" approach may not be appropriate.

The standardization of measures for schools in each sector raises opposition by institutional representatives. The measures do not fully take into account the differences that exist among institutions within a sector. For example, a majority of the same measures have been applied to MUSC and Clemson when they have radically different student populations. The majority of MUSC's students are graduate students. The representatives stated that institutions have different missions, and performance funding does not measure whether they accomplish these missions.

Representatives of institutions argue that the measures are most appropriate for a small, four-year, liberal arts college, and it is a mistake to evaluate all schools by the same measures. Some measures are not relevant for graduate education. For FY 01-02, CHE is working to develop separate measures for MUSC based on its graduate population; however, these measures will not be applied to the graduate population at other institutions such as USC or Clemson. In past years, MUSC has been scored on measures developed for undergraduate institutions. CHE staff are working to apply the most appropriate indicators to the different sectors and institutions within sectors.

Data Collection

We did not review the non-financial effects of performance funding on the institutions. CHE is in the process of evaluating these effects through a grant awarded by the Fund for the Improvement of Postsecondary Education (FIPSE). The FIPSE grant is a project that will focus on assessing the impact of the performance funding system on the colleges and universities. A report is expected in Fall 2001. We did note that institutional representatives cited the administrative burden of data collection as a negative of the performance measurement system.

Colleges and universities argue against the CHE's continued monitoring of all indicators. According to officials, the data collection is quite burdensome for something that is not related to a performance score. In addition, some data has been collected solely for CHE and is not used for any other reporting. For example, the indicator measuring credit hours earned of graduates required that staff manually pull a copy of all graduates' transcripts and review them to try to obtain the reason that they had more hours than required for their program. According to officials, USC has three full-time employees to collect data for performance funding. CHE would like to continue to monitor all indicators to allow for reinstatement of problem areas; however, requiring institutions to collect data that has no specific use does not represent an efficient use of resources.

Recommendation

4. The CHE should continue to work to improve the performance measurement process. Specifically it should:

- Use indicators that can be quantified.
- Reduce the administrative burden on institutions by using data collected for other purposes whenever possible.
- Ensure that indicators are appropriate to each institution based on the institution's unique mission and structure.

Performance Funding and the Elimination of Duplication and Waste

We reviewed the relationship between performance funding and efforts to eliminate duplication and waste in higher education and concluded that performance funding has had little effect on the elimination of waste and duplication.

Institutional representatives stated that the original intent of performance funding was to take funding from weak institutions and lead to their closure. However, none of the institutions has lost funding as none of them has scored below an "achieves." The CHE has promulgated regulations for the reduction, expansion, consolidation, or closure of an institution as a result of institutional performance, but the possibility of this occurrence seems remote. It is extremely rare for a public institution to be closed. An official with the Education Commission of the States could identify just one public institutional closure in the U.S. in the past 50 years.

One of the statutory performance indicators is "Elimination of unjustified duplication of and waste in administrative and academic programs." To measure performance on this indicator, the CHE has required each institution to report an exemplary example of how it has eliminated unjustified duplication and waste in both academic and administrative programs. We reviewed the reports submitted, which primarily provided narrative descriptions of institutional efforts to improve internal efficiency. The CHE has monitored this indicator in two previous funding years as a compliance indicator. No school was found to be in non-compliance. This indicator is now on a three-year cycle; the CHE will review it again in the FY 02-03 performance year.

Other Review Mechanisms

Institutions are required to obtain program approval from the CHE for any new programs they want to implement. According to CHE staff, if there is a problem with a program, they try to discourage the institution from submitting it. The CHE has generally not disapproved of formal proposals. The CHE encourages duplication of some programs to ensure accessibility to all citizens. For example, it would like many institutions to offer teacher education and nursing programs.

The CHE's review of existing programs also considers whether programs should be continued. The CHE has reviewed existing programs on a cycle by discipline since 1980; however, as of April 2001, program review is being suspended due to budget constraints. In program review, CHE brings in teams of out-of-state consultants and completes a structured review. The main purpose is to improve the programs. The consultants review issues of quality about faculty, students, and facilities. Program reviews result in one of three recommendations:

- Continue the program with full approval.
- Place the program on probation with a plan of action for improving.
- Terminate the program.

According to a CHE report in 2001, over a ten-year period from 1989 to 1999, 246 new programs have been established and 113 programs have been discontinued.

Data Verification

The CHE has implemented a data verification process that provides improved control over information used to evaluate performance. However, this process could be strengthened if the CHE had a policy to correct misallocation of funds that may occur due to data errors.

In our 1998 audit of Francis Marion University, we found that performance funding had been based on self-reported data from institutions. We recommended that the CHE implement a system for verifying the accuracy and consistency of data reported. Beginning in 1998, the CHE began to conduct data verification audits. The data verification process is a non-punitive process completed by the CHE staff and staff at the State Board for Technical and Comprehensive Education. The CHE plans to audit each institution every two years.

The CHE recently completed the first cycle of data verification audits and has begun the second two-year cycle. During the first cycle, the CHE implemented a form to show the effects of data changes on the scoring of indicators. Although there were some scoring changes, there were no changes that would have affected an institution's funding.

It is possible that data corrected as the result of a data verification audit could change the funding for which an institution is eligible. To ensure fairness among institutions, any errors should be corrected and funds redistributed.

The CHE allows the State Board for Technical and Comprehensive Education to conduct its own reviews because it is an independent governing board. Staff from the CHE assisted the tech board in the first cycle of audits, but will not be assisting in the current cycle due to budget constraints. The tech board has incorporated the data verification audit with its annual management audits completed by its audit staff. However, the tech board has not assessed the results of data verification audits to determine if funding changes are warranted.

Recommendation

5. In collaboration with institutional representatives, CHE staff and the State Board for Technical and Comprehensive Education should implement policies and procedures for the redistribution of funds based on data verification scoring changes.

Performance Improvement Grants

Since FY 97-98, CHE has set aside funds into a performance improvement pool to be awarded to eligible institutions to improve certain areas of their performance. State regulation 62-730.A.(3) states:

> The Commission on Higher Education shall ensure that funds up to $5,000,000 per year are set aside to assist institutions in improving their performance on one or more indicators where the performance score indicates that substantial improvements are needed.

This pool is derived from 0.25% of the allocation to the institutions. Funds are available to be awarded, based on a review of proposals, to institutions that receive ratings of Aachieves,@ Adoes not achieve,@ and Asubstantially does not achieve.@

We reviewed all awards from FY 97-98 through FY 00-01 to determine if funding was granted in accordance with CHE=s guidelines. We found no material problems with the award of performance improvement grants. Table 3.6 shows the total number of proposals approved and the amount awarded each year.

Table 3.6: Performance Improvement Grants, FY 97-98 Through FY 00-01

YEAR	NUMBER OF PROPOSALS		AMOUNT AWARDED
	RECEIVED BY CHE	FUNDED BY CHE	
FY 97-98	11	6	$157,007
FY 98-99	11	6	386,465
FY 99-00	9	8	1,337,315
FY 00-01	9	9	1,858,584
TOTAL	**40**	**29**	**$3,739,371**

Prior to 2001, the CHE did not conduct formal monitoring of the performance improvement grants after the award was made to the institution. Beginning in 2001, the commission plans to verify the expenditures of these performance improvement funds during the data verification visits. Without this verification, there is no guarantee that institutions will use the funds for the purpose for which they were awarded. Also, collecting information on the results of the projects could aid in evaluating their effectiveness.

Recommendation

6. CHE should follow up and review expenditures and results of the performance improvement grants.

Audit Scope and Methodology

We reviewed the results of performance funding by focusing on the Commission on Higher Education's (CHE's) implementation of Act 359, passed in 1996. The primary areas of review were the CHE's allocation of funds to higher education and its implementation of a performance measurement system. The CHE is involved in an ongoing research project to determine the effects of performance funding on the institutions, so we did not duplicate this work. We did not review other programs administered by the CHE. The period of review was from FY 96-97 through FY 00-01.

We obtained and reviewed evidence from the following sources at the CHE:

- Meeting minutes.
- CHE publications, data verification audits, and consultant reports.
- Policy manuals.
- Financial reports and other financial documents.
- Reports and other documents received from South Carolina institutions of higher education.
- Staff interviews.

We also interviewed officials with South Carolina institutions of higher education and with independent research organizations. We consulted with state budget officials and reviewed reports concerning higher education funding in other states.

The procedures we used to produce a simulated example of 100% performance funding (see p. 9) were based on our discussions with CHE staff about the appropriate methodology for this purpose. To determine the performance allocation, we first adjusted the CHE=s determination of needed funding (the MRR) for FY 99-00 to equal the total actual funds that were appropriated for that year. Thus, each institution=s need was adjusted down by the same percentage as the total need was adjusted to be in line with appropriations. Then we multiplied the adjusted need for each institution by its performance score as determined by the CHE. Each institution scored either Aexceeds@ (91%) or Aachieves" (77%) for that year. After this calculation (first allocation), there were still appropriated funds remaining to be distributed. We calculated what percentage of the first allocation had been received by each school and multiplied that percentage by the amount of remaining funds to produce the second allocation. The total performance allocation was the sum of the first and second allocations. We replicated this methodology for FY 00-01.

We measured compliance with the requirements of Act 359 and assessed the results of performance funding using principles of sound business practice. We reviewed management controls over performance improvement grant funding and data verification. We performed limited testing of computer-generated information that we used. However, the reliability of computer-generated data was not central to our audit objectives, and, when all evidence is viewed in context, we believe that opinions, conclusions, and recommendations in this report are valid.

Appendix A
Audit Scope and Methodology

Agency Comments

Appendix B
Agency Comments

South Carolina Commission on Higher Education
Response to
South Carolina Legislative Audit Council Report:
A Review of the Higher Education Performance Funding Process

One study of performance funding nationally cautions that implementation should be phased in gradually with plenty of opportunities for trial and error. Another study has referred to South Carolina's experience with performance funding as a "Star Trek journey into the unknown" because of the large number of performance indicators, the requirement to base all the funding on performance, and the short phase-in period mandated by the legislation.

Since 1996, when Act 359 was signed into law, the Commission on Higher Education has worked to implement performance funding as required in the legislation and to do so fairly and responsibly. As it has done so, it has gained increasing experience with the measures and has made corrections and improvements.

Through this process the Commission—working closely with the institutions, legislative staff, and the business community—has refined measures, gathered data, identified peer institutions, determined performance standards, validated its model for determining need, and then attempted to stabilize the system around a sub-set of scored indicators. As a result, performance funding in South Carolina has gained increasing respect nationally.

Changes approved for implementation in 2001-2002 will result in fewer and more appropriate indicators used in the scoring process, less reporting required by institutions, a larger proportion of indicators that are unique to individual sectors and individual institutions within sectors, and a more accurate overall assessment of institutional performance.

Given these changes and the complexity of the performance funding system, the Legislative Audit Council had an especially difficult task in assessing the Commission's implementation of performance funding.

The Commission on Higher Education wishes to compliment the Legislative Audit Council for reviewing a large amount of information, understanding a complicated process, and making sound recommendations. The Commission is substantially in agreement with the Council's recommendations and offers below a response under each of the headings in the report, noting disagreements with interpretations and providing additional information as appropriate.

Chapter 1: Introduction and Background

Funding for Higher Education

The report notes examples of "below-the-line" items that the General Assembly funded but that were not submitted to the Commission on Higher Education.

Recommendation and Response: The Commission agrees with the recommendation that institutions of higher education should comply with S. C. Code 59-103-35 and submit all requests for funding to the Commission on Higher Education.

Chapter 2: Allocation of Funds

Performance Funding

Since the end of the phase-in period in 1998-99, all the general operating funds allocated to higher education institutions have been subject to performance scores. The institutions' "base" budgets from the previous year have not been guaranteed and the amount of funding an institution has received has depended on its performance score. There are five categories of overall performance. In practice, institutions have performed in the "achieves" and "exceeds" categories. The differential between scoring in one category or the other has been approximately 3% of an institution's overall allocation. Thus, although all general operating funds have been subject to performance scores, the amount of financial impact has been more limited. The percentage, as the Legislative Audit Council correctly notes, is consistent with the highest percentages in other states that have performance funding. In South Carolina, however, the impact of performance is cumulative, not just annual. The amount of funding allocated in one year based on performance becomes the starting point for calculations in the following year. Thus the impact of performance is compounded from year to year, increasing the overall impact of performance on funding.

As the report points out, the Commission on Higher Education has attempted to achieve an appropriate balance between too much funding shifting from one institution to another in a single year based on performance, which would lead to budgetary instability, and sufficient funding impacting institutions so that the incentives and disincentives are taken seriously.

Recommendation and Response: The Commission on Higher Education believes that it has complied with the legislation in Act 359 of 1996 and therefore does not believe that a change in legislation is required. However, changing the phrasing from "based entirely" on performance to "based in part" on performance in S. C. Code 59-103-45 would provide more flexibility to the Commission on Higher Education in continuing to meet legislative mandates while working to improve South Carolina's higher education system.

Parity in Funding

The report accurately notes that disparities in funding have developed historically for the state's colleges and universities, unrelated to performance.

Recommendation and Response: The Commission on Higher Education agrees with the recommendation that funding should be phased in to achieve parity based on need.

Chapter 3: Measuring Performance

Indicators of Quality

As the report notes, it is difficult to produce a comprehensive assessment of all aspects of an institution's quality, given the limitations inherent in any measurement system. However, a number of the performance indicators do directly reflect institutional quality, and South Carolina has seen some increases in performance on these indicators since 1996. For example, institutions have moved more quickly to eliminate or improve programs found to be deficient in the academic program review. Also, the percentage of programs that are accredited has increased dramatically in some sectors, and SAT scores and other entrance requirement data have shown increases.

The first three years of performance funding were devoted to implementing first 14, then 22, and finally all of the indicators. In the fourth year the Commission on Higher Education developed standards for these measures based on national peer data and other data that it had gathered over the first three years of implementation. In the fifth year the Commission, based on recommendations from a nationally recognized consultant and input from institutions and the Commission's Business Advisory Council, developed a sub-set of the indicators for scoring purposes, selecting those that could best be measured and that were most relevant to the missions of different institutions and sectors of higher education. These changes have followed an orderly pattern and have taken place with input from institutional representatives, the Commission's Business Advisory Council, the Council of Public College and University Presidents, and other stakeholders.

The resulting set of measures identified for scoring purposes beginning in 2001-2002 may seem narrow, but that concern should be balanced against the opposite concern—that too many measures tend to diffuse institutional attention, complicate the measurement system, and add to reporting requirements.

To produce annual performance scores, the Commission on Higher Education has selected those indicators that best represent each of the 9 critical success factors specified in legislation. The critical success factor "Classroom Quality," for example, will be measured by the percentage of programs that are nationally accredited. The Commission selected this measure because it is a nationally recognized quality indicator reflecting a broad range of academic factors. The indicator the Legislative Audit Council report mentions as too narrow for this critical success factor, "Emphasis on Quality Teacher

Education and Reform," is actually an additional quality measure, not the principal one. It applies to the teaching university sector in recognition of the importance of teacher training to the missions of these institutions. The indicator the report suggests would be more universal, "Credit Hours Taught by Faculty," has been measured for several years. The Commission has found that it is less useful as a quality measure.

In commenting on the critical success factor "Institutional Cooperation and Collaboration," the report does not mention that the Commission on Higher Education collected substantial documentation on a broad range of examples of cooperation and collaboration. Only after it assessed the status of cooperation and collaboration efforts did the Commission restructured the measure to encourage institutions within each sector to work together to address more specific state needs and to address needs that may change over time.

In a similar fashion, with regard to the critical success factor "User Friendliness of the Institution," the Commission on Higher Education began its assessment with broader measures that included transferability, continuing education, and accessibility. The accessibility indicator itself included sub-measures of distance education and off-campus course delivery, as well as minority participation. Only after employing the broader measures and collecting and analyzing data on them did the Commission on Higher Education determine to focus for scoring purposes on what had emerged as the most significant area of concern—the under-representation of minority students and faculty.

The Commission on Higher Education intends to monitor for compliance with standards institutional performance on all indicators, including those that are not scored, and is in the process of developing methods of monitoring that will not require additional data collection and reporting.

Recommendation and Response: The Commission on Higher Education, as it has in the past, intends to work to improve performance measurement processes and agrees with the recommendation that indicators should be quantifiable, that administrative burdens should be reduced, and that indicators should be appropriate to each institution.

Performance Funding and the Elimination of Duplication and Waste

Although the Legislative Audit Council report suggests that performance funding may not have directly impacted duplication and waste, it should be noted that institutions, as documented in materials submitted to the Commission, have taken steps to reduce unnecessary duplication and waste in academic programs and administration. The Commission on Higher Education has measured efficiency and addressed issues of duplication and waste through several different indicators, including financial indicators that show that administrative costs and overhead costs for South Carolina institutions are generally lower than national averages. It should also be noted that most institutions have shown an increasing percentage of expenditure in academic areas and a decreasing percentage in administrative expenditures as they have sought to deliver programs more efficiently.

Recommendation and Response: The report did not include a recommendation on this section, but the Commission on Higher Education offers the comments above to demonstrate its efforts to assure accountability in this area.

Data Verification Review

The data verification process has helped to ensure that data reported by institutions is accurate and comparable. During the initial phase of data verification, the results of the reviews have been non-punitive. The data verification reviews have identified some reporting errors resulting from misinterpretation of definitions or procedural problems, but no deliberate misrepresenting of data. Also, none of the data verification reviews has resulted in changes in scores that would have produced differences in allocation.

Recommendation and Response: The Commission will be considering policies affecting the redistribution of funds based on data verification and agrees with the report's recommendation.

Performance Improvement Grants

The report notes the absence of material problems with performance improvement grants. As a result of reductions in state funding for higher education, it is likely that less funding will be available for performance improvement in the future.

Recommendation and Response: The Commission agrees that performance improvement grants should be monitored.

Conclusion

The Commission on Higher Education appreciates the recommendations of the Legislative Audit Council, the time and careful attention it paid to understanding performance funding processes and data, and the professional manner in which it conducted the review. Although it has noted some instances of possible misinterpretation or lack of complete information in the report, the Commission on Higher Education is in substantial agreement with the Legislative Audit Council's recommendations.