Incentive-based Budget Model – RELATED PROJECT
Incorporating UC Funding Streams into the Campus Budget

The University of California systemwide office – the Office of the President – has realigned its financial relationship with the 10 UC campuses through the recent approval by President Yudof of the UC Funding Streams Initiative. This initiative realigns the way funds flow within the University and the way the Office of the President and systemwide programs are funded.

This arrangement is critical to our campus discussion of a budget model because the UC Funding Streams Initiative allows the campus to retain virtually all revenue it generates instead of sending it to the university’s central office for re-distribution. This change enables the campus to develop an incentive-based budget model that directs campus revenues such as tuition and indirect costs to the units that generate that revenue.

Since university revenues are no longer flowing through the Office of the President, the central OP office and various systemwide programs will be funded, beginning in the current year, through an assessment or tax levied on campuses. This assessment, which is calculated as a percentage of over-all campus expenditures, needs to be incorporated into the campus budget.

THE FLOW OF FUNDS UNDER FUNDING STREAMS

With a September 2011 announcement, President Yudof made official UC's implementation of the Funding Streams plan (see Appendix I). That plan, developed at the direction of the president and in consultation with campus representatives from across the UC system, can be generally characterized in two ways:

*Campus-generated funding remains on campus.* Among the larger impacts of this aspect of the initiative are the following:

- The campus retains all tuition and fee funds generated by its own students.
- The campus retains indirect cost recovery funds generated from its own contract and grant activity.
- Patent revenues, net of payments to joint holders and inventors, are allocated to the source campus.
- Short-Term Investment Pool earnings are transferred to the campus.
- Office of the President assessments on medical center expenditures, auxiliary expenditures, and medical compensation plans are replaced with the campus-wide assessment or tax.
- Annual appropriations from the Office of the President for development and other activities have been eliminated.
The Office of the President and various systemwide programs are to be funded via a broad-based tax (assessment). As a replacement for the revenue that now flows to campuses instead of flowing, in part, to OP for support, the campuses are assessed a broad-based flat tax on campus funds. The tax rate for the initial implementation is 1.6% with approximately 0.7% being directed to fund central OP functions and 0.9% being used to fund systemwide programs (for example, the California Digital Library, Education Abroad, Cooperative Extension). The assessment is based on total current funds operating expenditures (excluding plant funds and financial aid funding) from all fund sources from the year two years prior (e.g. FY 2009-10 expenditures drive the FY 2011-12 assessment).

The university has provided campuses with discretion in identifying the fund sources that may be used to pay the systemwide assessment. While the tax liability is calculated based on expenditures from virtually all funds, such a tax would be an unallowable expense on restricted funds such as contract and grant funds or restricted gifts. Therefore, the campuses must identify other funds to cover the tax, and President Yudof explicitly states that the many fund sources that campuses may use to cover this liability include student tuition and fees, research indirect cost recovery, auxiliary and sales and service revenues.

Neutrality / Non-Neutrality. The original stated intent behind the funding streams initiative was to be financially neutral in year one. Put another way, in the first year of implementation, the additional revenue remaining on campus and the tax liability would offset one another, and the individual campuses would be no better and no worse off than they would have been had funding streams not been implemented.

However, the final Funding Streams calculations included a “non-neutrality” provision to recognize that the funds returned to the campuses are less than the cost of the new tax. Additionally, several programs previously funded with central funds were eliminated under funding streams -- including critical support for development -- so the campus must also recover the loss of budget authority for these programs. This non-neutrality effectively resulted in another budget cut for each campus.

FUNDING STREAMS AT UC DAVIS FOR 2011-12

For 2011-12 – the first year of implementation of Funding Streams -- all campuses face a tax liability payable to the Office of the President equivalent to 1.6% of total 2009-10 expenditures less plant expenditures and scholarship offset. For UC Davis, this amounts to a liability to UCOP in the current year of $41.5 million. In addition, $0.8 million for development, government and community relations and benefits counseling was eliminated resulting in a total impact on the campus of $42.3 million.

Since the campus is planning to begin implementation of a new budget model as of July 1, 2012, the campus is taking an interim, centralized approach to addressing its funding streams liability for 2011-12. This approach is outlined in Figure 1 below.

For the current year, the campus received $30.4 million in new funds (funds that had been going directly to UCOP) through funding streams and $2.9 million in eliminated assessments on the medical center, the medical compensation plan, and auxiliary enterprises. The remainder of the liability – the non-neutrality portion of the assessment – amounts to an additional budget reduction for the campus of $9.0 million.

Budget and Institutional Analysis
Distributing the OP Tax Beginning in 2012-13

As explained earlier in this paper, the OP assessment on campus expenditures is calculated as a broad-based tax on all expenditures net of the scholarship allowance and plant account expenditures.

The tax levied on the campus is typically described as 1.6%. The exact tax rate is actually 1.632% of net expenditures when accounting for rounding and the loss of support for local campus programs. However, as a campus, we will make several adjustments to the expenditure totals used by OP that result in a lower tax rate for campus units\(^1\) of 1.52%. See Appendix II for detail on this calculation.

Units will be responsible for covering the tax liability generated by their expenditures; however, they will receive additional funding to cover the liability stemming from General Fund/Tuition and research expenditures as follows:

1. Campus will allocate state general funds and tuition (19900) to units to fully offset their 2012-13 liability stemming from expenditures from general funds and tuition (column (1) in Display 2). This will be a base budget augmentation calculated at the actual 2012-13 liability. Moving forward, units will be expected to manage the general fund and tuition tax liability as part of their overall budget.

2. The campus is significantly increasing the share of Indirect Cost Return (ICR) funding being returned to units, and a portion of the new funding is available to cover the tax liability stemming from direct and indirect research expenditures (column (2) in Display 2).

\(^1\) The term unit as used in the working paper is intended to refer to the primary campus organizational units that are led by a dean, vice provost or vice chancellor.

---

Display 1

<table>
<thead>
<tr>
<th>2011-12 Funding Streams at UC Davis</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Liability and Sources</strong></td>
</tr>
<tr>
<td>($ in millions)</td>
</tr>
<tr>
<td><strong>Tax liability:</strong></td>
</tr>
<tr>
<td>UC Davis tax (1.6% x 2009-10 net expenses of $2.587 billion)</td>
</tr>
<tr>
<td>Discontinued program funding</td>
</tr>
<tr>
<td><strong>TOTAL liability</strong></td>
</tr>
<tr>
<td><strong>Sources to pay tax:</strong></td>
</tr>
<tr>
<td>Continue legacy assessments (health system, student housing)</td>
</tr>
<tr>
<td>Funds returned to campus from OP (ICR, State funds)</td>
</tr>
<tr>
<td>Central campus reserves</td>
</tr>
<tr>
<td><strong>TOTAL Sources</strong></td>
</tr>
</tbody>
</table>
Actual tax liability by unit and fund source for 2012-13 is listed below in Display 2.

<table>
<thead>
<tr>
<th>Academic Unit</th>
<th>General Funds And Tuition</th>
<th>Research</th>
<th>Other</th>
<th>Eliminated OP Assessments²</th>
<th>Net Tax not Off-set by New $</th>
</tr>
</thead>
<tbody>
<tr>
<td>CA&amp;ES</td>
<td>$1,226</td>
<td>$1,391</td>
<td>$360</td>
<td>$125</td>
<td>$360</td>
</tr>
<tr>
<td>CBS</td>
<td>$422</td>
<td>$592</td>
<td>$112</td>
<td>$61</td>
<td>$112</td>
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<tr>
<td>Engineering</td>
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<td>$748</td>
<td>$112</td>
<td>$74</td>
<td>$74</td>
</tr>
<tr>
<td>HarCS</td>
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<td>$61</td>
<td>$61</td>
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<tr>
<td>MPS</td>
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<td>$384</td>
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<td>$74</td>
<td>$74</td>
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<td>$57</td>
<td>$57</td>
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<tr>
<td>GSM</td>
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<tr>
<td>Law</td>
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<td>$912</td>
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<tr>
<td>Health System</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nursing</td>
<td>$-</td>
<td>$87</td>
<td>$1</td>
<td>$1</td>
<td></td>
</tr>
<tr>
<td>Medicine (3&amp;S)</td>
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<td>$1,849</td>
<td>$3,862</td>
<td>$22</td>
<td>$3,840</td>
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<tr>
<td>Hospital (H)</td>
<td>$50</td>
<td>$-</td>
<td>$17,490</td>
<td>$2,729</td>
<td>$14,761</td>
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<tr>
<td>Total, Health System</td>
<td>$742</td>
<td>$1,849</td>
<td>$21,352</td>
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<td>Univ Extension</td>
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<td>$280</td>
<td>$280</td>
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<td>Grad Studies</td>
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<td>$44</td>
<td>$44</td>
<td></td>
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<td>$6</td>
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<td>Research</td>
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<td>$604</td>
<td>$5</td>
<td>$599</td>
</tr>
<tr>
<td>IFT</td>
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<td>$-</td>
<td>$110</td>
<td>$110</td>
<td></td>
</tr>
<tr>
<td>OOP ³</td>
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<td>$5</td>
<td>$305</td>
<td>$305</td>
<td></td>
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<tr>
<td>Student Affairs</td>
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<td>$2,772</td>
<td>$139</td>
<td>$2,633</td>
</tr>
<tr>
<td>Univ Relations ⁴</td>
<td>$67</td>
<td>$-</td>
<td>$174</td>
<td>$174</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>$9,677</td>
<td>$8,177</td>
<td>$28,039</td>
<td>$2,895</td>
<td>$25,144</td>
</tr>
</tbody>
</table>

¹ Taxes in these columns will be directly offset with new appropriations to units.
² Reflects eliminated Office of the President assessments on the Medical Center, Med. Comp., and auxiliaries.
³ To be broken out into Office of the Chancellor and Office of the Provost.
⁴ University Relations to be broken out into Office of Development and other units.
In general, campus units will not receive any direct allocations to cover the tax liability for non-general fund and non-research expenditures (column (3) of Display 2). However, the campus will allocate additional ICR funds as part of the new budget model (see below) and will consider additional transition strategies for certain circumstances.

Units will have wide discretion on the funding sources to be used to cover the tax liability associated with these expenditures. President Yudof’s note in Appendix I addresses this point directly.

**Uses of Funds returned to the campus**

As noted earlier in this working paper, the funding streams initiative was initially framed as being fiscally neutral. However, the addition of the non-neutrality provisions and cuts in program funding for campus resulted in a net reduction in support for the campus of $9.0 million. Yet, the campus now receives funds that were previously held by the Office of the President.

The campus will allocate the new funds – $30.4 million as base or ongoing allocations – as follows:

- $9.7 million to offset the tax on general funds expenditures (Column (1) in Display 2),
- $8.2 million to offset the tax on research expenditures (column (2) in Display 2), and
- $12.5 million to increase the Indirect Cost Return revenue directed to campus units. (see Incentive-Based Budget white paper on ICR Funds at [http://budget.ucdavis.edu/budget-planning](http://budget.ucdavis.edu/budget-planning))

**Future Year Assessments**

Assessment rates in future years will be established as part of the Office of the President budget process (Regents Policy 5101). Total campus liability and liabilities across the units will shift with changes in expenditure levels across various units. Since the tax liability is based on expenditures from two years prior (e.g. 2010-11 expenditures will drive 2012-13 assessments), units will be able to calculate their tax liability well in advance of the start of any fiscal year.
Appendix I
President Yudof’s Letter Approving the Implementation of the Funding Streams Model.

UNIVERSITY OF CALIFORNIA

BERKELEY • DAVIS • IRVINE • LOS ANGELES • MERCEDES • RIVERSIDE • SAN DIEGO • SAN FRANCISCO SANTA BARBARA • SANTA CRUZ

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September 12, 2011

CHANCELLORS

Dear Colleagues:

Following lengthy consultation with campus leadership, in December, the Office of the President (UCOP) distributed a proposal, known as the Funding Streams Initiative, to make comprehensive changes in the way funds flow within the University and in the way UCOP is funded. We have received and reviewed comments from campuses, student organizations, and the Academic Senate, and the proposal has been discussed with the Regents. The proposal has been met largely with favorable responses.

At this time, I am writing to tell you that the Funding Streams Initiative is approved, albeit with some changes from the original proposal. I know that your campus budget and accounting staffs have been working closely with my office on implementation for 2011-12, and I want to thank you for their cooperation and patience during a difficult transition.

The major components of the new Funding Streams Initiative are:

Retaining Funds at Source Campuses

In order to simplify University financial activity, improve transparency, and incentivize campuses to maximize revenue, beginning in 2011-12, all campus-generated funds will be retained by or returned to the source campus. The following current policies and practices that redistribute funds to the Office of the President and/or other campuses are eliminated or changed as follows:

- Each location will retain all tuition and fee funds generated from its own students, when necessary to maintain a common loan/work expectation for undergraduates across the system.
- Each location will retain all indirect cost recovery funds generated from its own contract and grant activity.
- All patent revenues, net of payments to joint holders and inventors, will be allocated to source locations.
- All Short-Term Investment Pool earnings, regardless of fund source, will be transferred to source locations.
- Each campus will retain its own graduate application fee revenue. Undergraduate application fee revenue will be distributed proportionately to the number of applications received by each campus.

Budget and Institutional Analysis
Appendix I (continued)

Chancellors
September 12, 2011
Page 2

Existing assessments on medical center expenditures, auxiliary enterprise expenditures, and medical compensation plans that support UCOP administration through the Office of the President Common Fund will be eliminated.

Systemwide Assessment

In order to support central operations (defined as UCOP administration and central services, UCOP-managed academic programs, systemwide initiatives and ongoing commitments, multi-campus research programs and initiatives, and the Division of Agriculture and Natural Resources Cooperative Extension), the University will establish a broad-based flat assessment on campus funds. The assessment will replace the funding for central operations previously provided by General Funds, Opportunity Funds, Off-the-Top Funds, Educational Funds, and the Common Fund taxes on medical center, health sciences compensation plan, and auxiliary enterprise expenditures. The assessment will not replace funding for central operations and programs derived from State Specific Funds, State Special Funds, contracts and grants, and systemwide endowments.

The total amount of the assessment will be based on a regular review of the budget for central operations. The campus distribution will be based on total current operating expenditures from all fund sources during the most recently completed year.

I am authorizing broad discretion to campuses in identifying the fund sources from which the systemwide assessment will be paid. While certain federal, State and private contract and grant funds will likely not be available to cover assessment charges, campuses may use student tuition and fees, research indirect cost recovery, sales and service revenues, and other sources. While decisions will be made locally, I encourage Chancellors to consult with students about the use of tuition and fee funds, particularly campus-based fees voted on by students. We will ask The Regents in November to make all such tuition and fee funds eligible for payment of the systemwide assessment, but decisions to do so must be carefully considered.

Undergraduate Financial Aid

As an exception to the overarching principle that source campuses will retain all funds generated by the campus, redistribution of some funds will continue as a means to support the systemwide goals of the Education Financing Model (EFM) for undergraduate student financial aid. A key feature of the EFM, which I heartily endorse, is the goal to use fee funds to equalize the expected student contribution level from employment and/or loans across the system, such that each individual undergraduate student would face the same net costs regardless of which campus the student chooses to attend. Maintenance of the EFM goal will be managed through the use of State Specific Funds and, if necessary, tuition or other funds.
Appendix 1 (continued)

Chancellors
September 12, 2011
Page 3

Graduate Financial Aid

Because the distribution of graduate University Student Aid Program (USAP) funds has been based on the systemwide goal of offsetting campus cost increases rather than addressing student need, the cross-subsidization of financial aid at the graduate level is eliminated going forward. Instead, each campus will retain the total amount of tuition and fee revenue generated by its graduate students and, each year, campuses will be directed to allocate a specific share of tuition and fee revenues to graduate student support and fee remissions.

General Fund Cost Increases and Future State Funding Augmentations and Reductions

As described, for many years it has been the University’s policy to pool State General Funds, UC General Funds, and Tuition (formerly Educational Fee) increase revenues available to support cost increases for salaries, benefits, and non-salary items and to allocate funds to campuses on the basis of General Funds budgets. During many years, the University has been assigned undesignated cuts in State funding, and student fees have been increased to help the University address these cuts as well as unavoidable cost increases, with both cuts and new fee revenue distributed on the same General Funds budget basis. Due to variation in the size of General Funds budgets relative to student populations, some tuition revenue was transferred among campuses. Under the new model, because campuses will retain tuition revenues, this transfer will no longer occur and campuses with high budgets relative to the number of students will need to identify other solutions to inadequate State support. The problem is particularly acute for the San Francisco campus, which has no undergraduate population and, therefore, generates a relatively low amount of tuition and fee revenue relative to its total budget.

The Funding Streams Initiative proposal distributed in December suggested that any future undesignated State funding augmentations be allocated on the basis of State General Funds and Tuition (net of financial aid). Nonresident Supplemental Tuition, Professional Degree Supplemental Tuition, federal indirect cost recovery, and other UC General Funds would be excluded from the distribution, based on the view that campuses should generate cost increase revenues from these fund sources and should not be rewarded with additional State funding as a result of increasing these non-State revenue sources.

The proposal further suggested that any future undesignated reductions in State funding be allocated on the basis of State General Funds, Tuition, Nonresident Supplemental Tuition, and Professional Degree Supplemental Tuition (net of financial aid). Increases in Nonresident Supplemental Tuition and Professional Degree Supplemental Tuition revenue would be included in order to more appropriately recognize campus capacity to cope with State funding reductions. I have concluded that this discrepancy between the proposed distribution of undesignated augmentations and the proposed distribution of undesignated reductions would appropriately penalize campuses that are successful in realizing new revenues from nonresident supplemental tuition and professional degree supplemental tuition.

Budget and Institutional Analysis
Appendix I (continued)

Chancellors
September 12, 2011
Page 4

As you know, as a follow-up to the Funding Streams Initiative, a working group of UCOP and campus leadership is reviewing the level of resources available to each campus on a per student basis. The outcome of this work will likely mean that there will be further changes in the way future undesignated augmentations and reductions are distributed.

For the time being, I am modifying the Funding Streams Initiative such that both undesignated augmentations and undesignated reductions will be distributed on the basis of State General Fund and Tuition budgets (net of financial aid). This decision will influence the methodology used to distribute the reductions in State funding for 2011-12.

Implementation

Implementation is being handled by UCOP Budget and Capital Resources and Financial Management units. Representatives from these offices have been working with the appropriate staff on your campuses to achieve the goals of the initiative.

I very much appreciate your patience on this project. I believe the outcome of the Funding Streams Initiative will enhance transparency and will help set the ten campuses on a path toward continued excellence in the coming years.

With best wishes, I am,

Sincerely yours,

Mark G. Yudof
President

cc: Provost Pitts
Executive Vice President Brostrom
Executive Vice President Taylor
Senior Vice President Stobo
Vice President Lenz
Vice President Beckwith
Vice President Sakaki
Vice Provost Carlson
Vice Provost Greenstein
Vice Provost Rumberger
Associate Vice President Obley
Executive Vice Chancellors
Vice Chancellors for Planning and Budget
Campus Budget Directors

Budget and Institutional Analysis
Appendix II

Calculation of the campus assessment rate

The OP tax is initially calculated by taking the total campus expenditures from the year two years prior as generated by UCOP corporate data report CFRU 1521. Scholarship allowances and plant account expenditures are netted out of the total before applying the assessment of 1.632%

The campus makes several adjustments to the expenditure levels as detailed in the bullets below. Taken together these changes result in a lower effective tax rate, which will be 1.52% for 2011-12 and 2012-13.

- The total campus expenditure amounts generated by OP include a substantial offset or negative expenditure driven by technical accounting adjustments in centrally managed accounts at Accounting and Financial Services. By removing these negative expenditures from our campus calculations, the tax rate needed to generate funding to meet the campus liability goes down.

- There are a small number of expenditures that we cannot assign to a unit, so we have effectively distributed those expenditures across the campus units. We have distributed expenditures from the campus centrally managed budget accounts (tax liability of roughly $5,120) and accounts that we are unable to assign to a unit (tax liability of roughly $5,000). These adjustments drive up the assessment rate by roughly 4 ten-thousandths of one percent.
Appendix III

### 2010-11 Campus Net Expenditures\(^1\) by Unit and Fund Source

*Per OP report CFRU 1521

*Used to Calculate 2012-13 OP Tax Liability*

<table>
<thead>
<tr>
<th>Academic Units</th>
<th>General Funds</th>
<th>Research</th>
<th>Other</th>
<th>Total – All Fund Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>CAES</td>
<td>$80,688,000</td>
<td>$91,541,000</td>
<td>$23,704,000</td>
<td>$195,933,000</td>
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<tr>
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*Health System*

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<tr>
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<th>General Funds</th>
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<th>Other</th>
<th>Total – All Fund Sources</th>
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<td>$3,299,000</td>
<td>-</td>
<td>$1,150,646</td>
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<td>Total, Health System</td>
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<td>$28,177,000</td>
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</table>

*Grad Studies*  $16,938,000   $2,459,000  $2,919,000  $22,316,000  
*Library*      $17,860,000   $46,000    $397,000    $18,303,000  
*Research*     $14,281,000   $47,460,000 | $16,139,000 | $77,880,000  

*ARM* $90,289,000 $880,000 $39,759,000 $130,928,000 
*IET* $11,843,000 - $7,208,000 $19,051,000 
*OCP* $11,860,000 $342,000 $20,072,000 $32,274,000 
*Student Affairs* $81,473,000 $61,367,000 $182,346,000 $325,186,000 
*Univ Relations* $4,400,000 - $11,471,000 $15,871,000 

Total – All Campus Units $636,701,000 $538,023,000 $1,844,810,000 $3,019,534,000

\(^1\)Campus expenditures are net of scholarship allowance and plant account expenditures.

\(^2\)To be broken out to Office of the Chancellor and Office of the Provost.

\(^3\)University Relations to be broken out into Office of Development and other units.