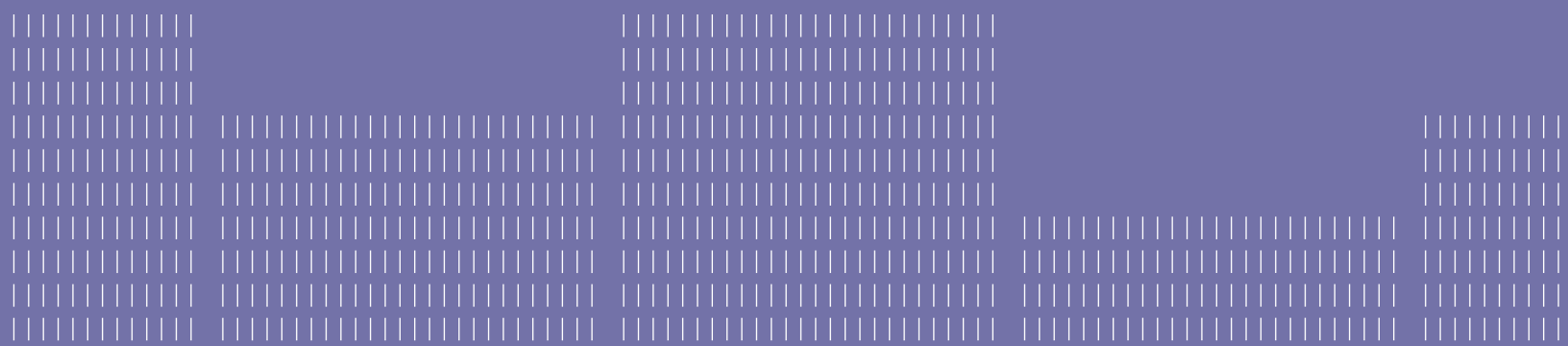


Resource Management, Planning and Allocation

An Updated Budget Overview
Fiscal Year 2008-2009

Steve Barclay
Senior Vice Chancellor
July 2008



The UCSF Financial Environment

At a time when dramatic advances in science, medicine and technology have presented UCSF with unparalleled opportunities to improve human health, UCSF faces the challenge of steadily declining state financial support.

In fact, UCSF has had to deal with mandatory cuts to its state-funded budget for 14 of the last 18 years. The state's financial situation has also meant inadequate funding for UCSF to pay utility expenses, despite a more than 40 percent increase in the past six years, as well as inadequate funding for basic operating and maintenance costs for most of the new, state-eligible facilities at the Mission Bay campus. The overall effect of this continuous budget cutting has meant that all UCSF organizations have had to shift basic instruction, academic support and institutional support activities off state funds and onto fund sources that have been traditionally used for the strategic advancement of UCSF through initiating or expanding innovative programs for the future. In essence, Chancellor J. Michael Bishop has had to use these strategic, discretionary resources just to keep the lights turned on. We are now being told to expect an additional 15 percent increase in the cost of utilities in FY 2009 alone. The cumulative effect of the state budget cuts, coupled with enormous increases in student fees in the past six years to replace some of the lost state funding, has also impacted our ability to compete in recruiting the best professional and graduate students and the best faculty, as well as in retaining those already at UCSF.

Despite the appearance of this being the worst of financial times, it was, ironically, also the best of times in that for the first time in more than 30 years, UCSF was finally able to undertake a major expansion of its facilities, more than doubling the available research space, tripling the number of students it could house, doubling its parking capacity and tripling its campus community spaces. New seismic laws for hospitals are requiring UCSF to build a new hospital, currently planned for the Mission Bay campus, and life-safety and seismic code requirements necessitate a major upgrading of its Parnassus campus facilities and infrastructure.

In order to maintain our momentum, aided by a new and aggressive strategic plan for the campus, it's become apparent that a rethinking of our resourcing model is needed. The constraints on traditional funding sources are forcing us to look for new, robust revenue sources. The planning dynamic of continuing to build new facilities while also having to maintain and upgrade older facilities, combined with a need to recruit and retain the best faculty, students and staff, points to the need for this rethinking.

What follows is a glimpse of some of the first initiatives that have come from the current, but ongoing redesign of the UCSF resource planning, budgeting and allocating process.

UCSF Executive Budget Committee Recommendations

Each year, the Chancellor's Executive Budget Committee (EBC) provides the chancellor with funding recommendations for campuswide initiatives (see the companion document, "UCSF: A Complete Budget Process Overview FY 2008-2009").

This year, the EBC is considering three primary recommendations. An overview of the three recommendations is provided below. As detailed in the companion document, the chancellor will review these recommendations in July and final decisions will be made in September 2008.

Information Technology and Infrastructure Funding Model

One of the strategic plan's priorities is identifying a funding model to support the campus's critical demand for voice and data services.

In October 2007, the Chancellor's Executive Committee commissioned a Data and Voice Services Advisory Committee (DVSAC), co-chaired by Ron Arenson, chair of the Department of Radiology, and Rob Duca, associate dean of the School of Pharmacy, to recommend a strategic approach and methodology to fund this escalating demand. Over the following five months, DVSAC and Huron Consulting Group performed a business case analysis examining the current state of the campus's IT network and infrastructure, the cost of needed upgrades and improvements over the next five years, and alternative funding models to generate funding. Of the total \$104 million required, \$41.8 million has been committed from

the chancellor's resources, leaving \$61.8 million to be funded over the next five years.

The Huron analysis looked at five alternative funding models and recommends the Capitated Model to generate the annual \$12.4 million a year needed over the next five years. This model generates revenue through a monthly fee which is determined by the total investment needed, the number of full-time equivalent (FTE) positions that will pay the monthly fee, and the investment time frame (ramp-up period and replacement cycle). The recommended method is to assess the Data FTE population (excluding students and non-IT users). Based on this approach, the proposed monthly fees range from \$25.00 (year one of five-year ramp-up period) to \$89.98 (year five, end of ramp-up period).

The EBC is evaluating the proposal with the understanding that year one of any new charge would begin in FY 2009-2010.

University Development and Alumni Relations (UDAR) Funding Model

As the percentage of state funding to total funding decreases and we work to offset resources with increased private support, it will become increasingly important to ensure that funding for sponsored activities covers the full cost of those activities. The costs in question include the cost of securing the funds, as well as the costs of facilitating and housing the program or activity. The importance of covering these ancillary costs has long been understood by the federal government (indirect cost rates), and awareness among sophisticated foundations is increasing. ►

The most common way to match sources and costs is through the application of indirect charges on private gift and endowment distributions, and several of our peer institutions (Massachusetts Institute of Technology, the University of Pennsylvania and the University of Southern California) have instituted policies that do just that.

Historically, the goal of our private gift funding model has been limited to funding operations within the office of University Development and Alumni Relations (UDAR). As it currently stands, this model cannot generate sufficient revenue to support the campus's fundraising needs.

Since FY 2005-2006, the model has incorporated the following assessments:

- 4 percent Gift Fee
- 1 percent Spending Fee
- 0.35 percent Administration Fee
- 75 percent Short-Term Investment Pool (STIP) Fee

In order to more accurately align the private sponsorships with the pursued activities, two models have been proposed. The first model was put forth by UDAR and the second model was developed by the Huron Consulting Group. Components of the two models include:

1. UDAR Model

- 1 percent to 5 percent Gift Fee (based on size of gift)
- No Spending Fee
- 0.40 percent Administration Fee
- 100 percent STIP Fee

2. Sponsored Activities Model

- 5 percent to 15 percent Indirect Cost Rate on Endowment Earnings and Gift Expenditures
- 0.40 percent Administration Fee
- 100 percent STIP Fee

The EBC is evaluating the model with the understanding that implementation of an alternative development funding model would begin in FY 2009-2010.

Indirect Cost Recovery

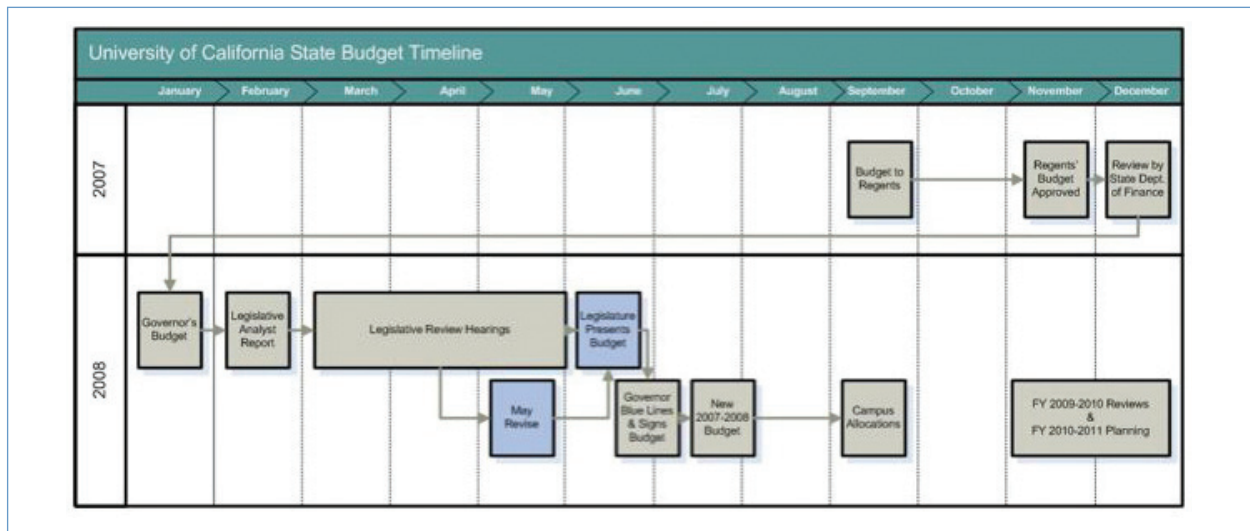
During FY 2006-2007, 21 percent of our expenditures were covered through grants and contracts. These expenses included both direct costs – costs that can be identified specifically with a particular sponsored project, such as salaries, software and equipment – and indirect costs – costs that are incurred for common or joint objectives of the University, such as space and administrative overhead. Indirect cost recovery (ICR) is the revenue received from sponsoring agencies to reimburse the University for the grants' or contracts' share of the indirect costs incurred to support the sponsored research.

Three years ago, the EBC recommended that the ICR allocations to the schools be a calculable share of UCSF's ICR rate. That recommendation was accepted, and each year, a portion of UCSF's ICRs is distributed to the schools to help offset their portion of research administration. The FY 2007-2008 ICR allocations provided to the schools totaled \$17,060,000.

In order to continue providing a reasonable amount of resources for incremental off-campus activity, the EBC is now considering amending the calculation for FY 2008-2009 to be based on the academic department administrative component for off-campus activity, net of withholdings by the UC Office of the President. This is consistent with the methodology used over the past three years in calculating the on-campus activity increment.

Applying this methodology consistently to both on-campus activity and off-campus activity would increase the proposed allocation for FY 2008-2009 by \$531,000 for a total permanent and temporary allocation of \$17,591,000.

University of California State Budget Process



The 2008-2009 Budget Year

UCSF's 2008-2009 fiscal year Annual Budget and Planning Review process began on February 25, 2008, when Chancellor J. Michael Bishop distributed his annual call letter to each financial control point. Chancellor Bishop's letter was designed to kick off UCSF's eight-step submission, review and approval process (see the companion document, "UCSF Budget Process Overview").

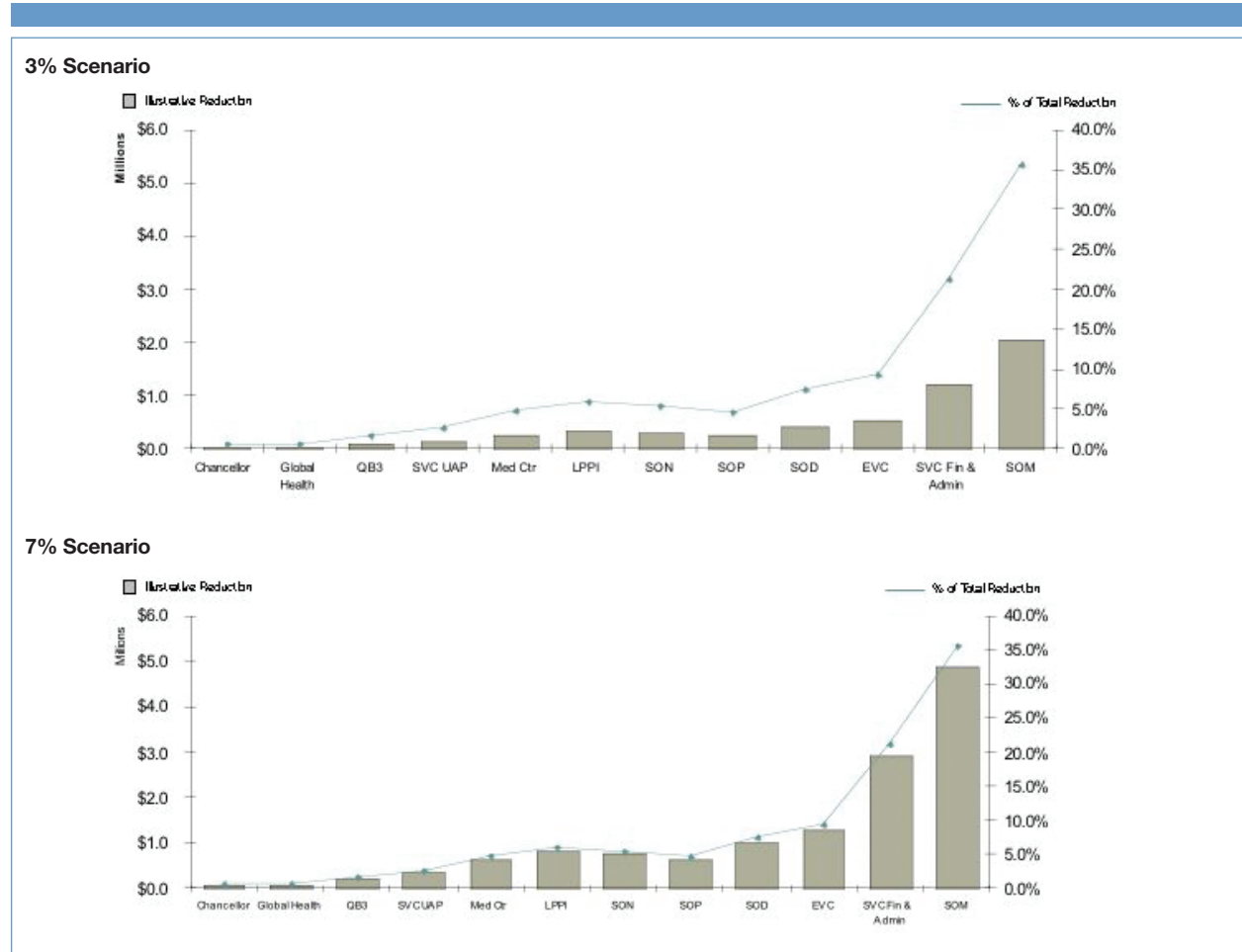
The assumptions used in the letter were developed primarily by the UC Board of Regents as a result of the UC State budget process (Display 1), and Chancellor Bishop's letter explained that the governor's proposed across-the-board state spending cuts would significantly impact our operations. While our compact with the governor remains, the cuts are driven by targeted allocation reductions and expenditure increases.

Since that time, through the legislative hearings and the governor's May Revision (Display 1), Katie Lapp, UC's executive vice president for business operations, the Regents and many others have worked with the governor and the Legislature to reduce the impact of the proposed reductions. Due in part to

those efforts, the proposed UC budget reduction target has been reduced, and it is our hope that some relief may be provided.

The governor's proposed May Revision would essentially leave UC's state-funded budget for FY 2008-2009 at the same level as the FY 2007-2008 budget, without providing additional funds for enrollment growth, inflationary cost increases (including salary and benefit increases), or investment in high-priority needs such as expanded student mental health services. Both budget reductions and student fee increases will be needed to address the shortfall. However, the final state budget signed by the governor, as well as any actions by the Regents to implement the budget (including salary increases), will dictate the actual cuts UC and UCSF must make. Given what is currently known about FY 2008-2009 costs, a budget reduction of between 3 percent and 7 percent is probable. This would amount to a cut in total state funding of approximately \$6 million to \$14 million at UCSF. ▶

Estimated 2008-2009 Permanent Budget Reductions



Assuming cuts are taken across the board, Display 2 illustrates how both reduction scenarios would impact UCSF's control points (groups reporting to the chancellor). However, we believe an across-the-board application of the reduction would be counter to our resource management, planning and allocation work to date, since it would not consider the importance of our strategic initiatives or annual priorities. Across-the-board reductions also disproportionately impact departments with the largest dependence on state funds.

Rather than an across-the-board approach, we must look for reductions in low-priority initiatives as a means to create funding for high-priority initiatives.

To facilitate that approach, Chancellor Bishop's letter requested that control points identify a 3 percent and a 7 percent reduction scenario for their UC General Fund permanent budgets. The chancellor has received all of the proposals, and control point consultations are now underway. These consultations will help determine the feasibility and impact of each scenario. Decisions on how best to make these cuts will be made by the chancellor (see the companion document, "UCSF Budget Process Overview").

Display 3 provides some of the principles that the chancellor and control point leaders plan to use as a guide to govern this process.

Principles and Guidelines to Govern Budget Reductions

1. The cause and the case for budget reductions will be communicated clearly and systematically.
2. The engagement and decision processes and criteria for choosing reductions will be transparent; outcomes and their reasons will be reported.
3. The process will be sensitive to key aspects of the best of UCSF's culture.
4. Core academic capabilities will be the least impacted, followed by compliance and control capabilities.
5. Reductions and potential reallocations will also be judged on the basis of alignment with UCSF's Strategic Plan.
6. Administrative costs, defined very broadly – from central to departmental administration – will be a key focus of the budget adjustments.
7. Recognizing that good administrative support is critical to leveraging faculty members' core activities of teaching, research and patient care, administrative costs should not "automatically" bear the full brunt of cost reductions; non-core programs will be a focus as well.
8. Revenue options, where feasible, will be invoked to reduce the size of expense reductions.
9. Reductions will not be made across the board.
10. Proposals for budget reductions, retention of current levels of funding, or potential revenue options will require business cases exploring the full impact (all externalities) of proposed actions.
11. Reductions in staff will be achieved as much as possible through attrition; critical vacancies will be filled with internal candidates where possible.
12. Strategic investments will be made if they reduce future continuing costs sufficiently, and preserve or enhance service and compliance and control capability.
13. Use of central reserves will be justified only to ease transitions to well-defined permanent budget-reduction solutions.

More Information

Supporting material is provided in our companion document, "UCSF: A Complete Budget Process Overview 2008-2009." The companion document contains:

- UCSF: Budgeting Goals and Priorities
- Overview of UCSF's Sources and Uses of Funds
- UCSF Budget Process Overview
- Recommended Resource Management, Planning and Allocation Strategies
- UCSF Executive Budget Committee Recommendations (FY 2008-2009)
- The 2008-2009 Budget Year
- Our Next Steps

More information is also available on the new budget website at budget.ucsf.edu.

