

Office of the President

TO MEMBERS OF THE FINANCE AND CAPITAL STRATEGIES COMMITTEE:

DISCUSSION ITEM

For Meeting of January 24, 2018

UNIVERSITY OF CALIFORNIA OFFICE OF THE PRESIDENT FISCAL YEAR 2018-19 BUDGET PROCESS

In response to the April 2017 California State Auditor (CSA) recommendations, the UC Office of the President (UCOP) is working to improve its budget process to increase consistency, transparency, and efficiency, solicit greater stakeholder input during the budget cycle, and deliver complete and transparent budget presentations. The CSA Budget Process and Presentation Recommendations are presented in Attachment 1.

The purpose of this item is to provide a progress update for the FY2018-19 budget to be presented in May 2018.

- Section I provides an overview of the FY2018-19 budget process.
- Section II describes the campus-led Executive Budget Committee established in August 2017 for the purpose of providing input into the UCOP budget.
- Section III identifies potential external and internal factors impacting the FY2018-19 budget.
- Section IV describes a proposed budget methodology for strategic projects, priorities, and initiatives, which would replace the current practice of utilizing unspent surpluses and President's Initiative funds with a smaller, more transparent, budgeted fund.

These improvements build on significant changes made to the FY2017-18 budget presentation in May, June, and July 2017.

I. Changes to the FY2018-19 UCOP Budget Process

This year's budget process introduces a number of improvements including:

- a two-phased budget approach
- targeted zero-based budgeting for travel, meetings, outside professional services, and temporary labor
- revenue budgeting
- forecasting to better leverage actual projected expenditures
- other changes designed to improve the completeness, accuracy, and transparency of the budget

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The FY2018-19 budget process started in November 2017 with the Phase 1 budget guidance as shown in Attachment 2. The guidance focuses on a rigorous review of actual expenditures, accurate baseline budgeting, requests for detailed information regarding changes to baseline budgets, and required data entry into the budget system. Among many potential benefits, the first phase is expected to:

- Support budget development by improving accuracy of revenue and expense planning
- Improve access to data in the budget system for better quality control and analysis
- Initiate an understanding and discussion of divisional and departmental priorities and needs for the upcoming FY2018-19 fiscal year
- Account for unavoidable expense increases (e.g., benefits rate, contractual increases), or decreases
- Set the expectation that budget trade-off decisions are required with the goal of tightening and controlling expenditures and operating costs at UCOP

The second phase, scheduled to commence in January 2018, will incorporate improved assumptions and address macro internal and external factors affecting the budget, discussed in Section III below.

II. Broadened Stakeholder Involvement

The CSA recommended UCOP “increase campus stakeholder input in the budget development process by reconvening the campus budget committee and establishing an agreed upon charter that describes the committee’s scope, role, and protocol for reviewing and providing comments on the Office of the President’s annual budget.”

In response, the Executive Budget Committee (EBC), comprised of representatives from the campuses, Academic Senate, and UCOP, was reconvened in August and has an established charter describing its scope, role protocols, and membership. The EBC has met monthly, focusing on FY2017-18 UCOP division budgets, CSA requirements and progress, and details of the UCOP FY2018-19 budget process.

In addition, the budget process was reviewed with division leaders, chiefs of staff, budget coordinators and other UCOP stakeholders culminating in the approval of the President. These stakeholders and the EBC will continue to be involved through the completion and presentation of the budget to the Regents in May 2018.

III. Factors affecting the UCOP FY2018-19 Budget

Several potentially significant internal and external factors will affect the FY2018-19 budget, including:

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- Assembly Bill 97 (AB97) requiring redirection of \$15 million for undergraduate enrollment growth. UC submitted a report to the Department of Finance and Joint Budget Committee which identifies \$15 million from the UC budget, of which approximately \$9.5 million includes reductions to the UCOP budget
- CSA-related recommendations and their financial impacts (Reserve Policy, Expense/Benefit Policies, Budget Process, Systemwide Programs and Initiatives)
- Potential changes to the UCOP organizational structure
- Source of revenue (State general funds v. campus assessment)
- Planned expansion of the UCPath Center to support additional campus employees migrating to the UCPath system
- Strategic Priorities Fund, as outlined in section IV below
- Other factors such as changes in salary programs (e.g. merit, recognition programs); changes in the vacancy factor; and/or unavoidable cost increases (e.g. benefits rate, contractual increases).

IV. Proposed Strategic Priorities Fund

The CSA recommends that the budget presentation “combine both the disclosed and undisclosed budget into one budget presentation.” The “undisclosed” budget refers to the past practice of utilizing year-end unrestricted budget surpluses as a “one-time, temporary” fund to address term-limited emergent, urgent, strategic, and/or operating issues.

In response, UCOP proposes creating a budgeted Strategic Priorities Fund to address term-limited priorities and initiatives which would emphasize the use of unrestricted endowment proceeds, interest income, and other unrestricted sources. In addition, the President’s Initiative Fund (PIF), currently budgeted at \$9.8 million, less \$2 million per the AB97 redirection, would be eliminated as a separate line item and incorporated into the Strategic Priorities Fund (SPF). Proposed guidance for the administration of the fund is outlined in the Presidential Guidelines Governing the UCOP Strategic Priorities Fund (Attachment 3).

Actual annual expenditures and commitments for the combined one-time and PIF funds over the past two years range between \$50 and \$60 million. The proposed guidance recommends the Strategic Priorities Fund be budgeted annually at a significantly lower level of \$30 million per year. This reduction of \$20 to \$30 million, from the prior two years, cuts allowable spend for these priorities in half.

UCOP will achieve this reduction in one-time spending by improving the processes for identifying, prioritizing, and tracking term-limited commitments. The SPF guidance identifies items that are eligible for funding. Commitments known at the time of the budget presentation will be identified. The guidance also requires approval of the Chair of the Board of Regents regarding expenditures exceeding \$5 million. Lastly, the SPF guidance details specific improvements in the reporting of commitments, actual expenditures, and the fund balance which will be implemented. In future years, any change to the \$30 million allocation will be requested as part of the annual budget process.

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Key to Acronyms

CSA	California State Auditor
EBC	Executive Budget Committee
PIF	President's Initiative Fund
SPF	Strategic Priorities Fund
UCOP	UC Office of the President

Attachment 1: CSA Budget Process and Presentation Recommendations

Attachment 2: UCOP Budget Guidance #1, November 2017

Attachment 3: Presidential Guidelines Governing the UCOP Strategic Priorities Fund

CSA Budget Process and Presentation Recommendations

CSA Budget Process Recommendations:

By April 2018:

- Increase campus stakeholder input in the budget development process by reconvening the campus budget committee and establishing an agreed upon charter that describes the committee's scope, role, and protocol for reviewing and providing comments on the Office of the President's annual budget.

By April 2019:

- Implement the best practices for budgeting identified by GFOA and NACUBO, including developing budget policies and procedures and formally documenting, approving, and justifying all one-time and unexpended expenditure requests.

By April 2020:

- Evaluate its budget process to ensure it is efficient and has adequate safeguards that ensure staff approve and justify all budget expenditures. If the Office of the President determines that its safeguards are sufficient, it should begin developing a multi-year budget plan.
- Report to the Regents on the amount of funds it reallocates to campuses as a result of implementing our recommendations.

CSA Budget Presentation Recommendations:

By April 2018:

- Implement our recommended budget presentation shown in figure 11. Specifically, the Office of the President's budget presentation to the Regents should include a comparison of its proposed budget to its actual expenditures for the previous year. It should also include all its expenditures and identify changes to the discretionary and restricted reserves. The Office of the President should combine both the disclosed and undisclosed budget into one budget presentation.

By April 2019:

- Continue to present a comprehensive budget based on the presentation in Figure 11 to the Regents, the Legislature, and the public.

UCOP Budget Guidance #1, November 2017

UCOP FY2018-2019

November Budget Guidance and Baseline Budgeting

Budget Guidance #1

Instructions for Phase One Budgeting (through December 19, 2017)

1) Overview

Welcome to the FY2018-2019 UC Office of the President budgeting season. This year's budget process introduces a number of improvements including; a two-phased approach, new budgeting processes, new planning guidance, targeted zero-based budgeting, a requirement for forecasting, and other changes as detailed below. These changes are part of our commitment to improve UCOP's budgeting practices, streamline processes, and create a transparent and comprehensive budget.

Adherence to the planning guidance, targets, and communicated timelines will be *critical* in order to achieve our required multiple stakeholder review process and submit a complete budget in time for the Regents meeting in May 2018.

We understand that these changes will require a different level of effort from both the departments and the UCOP Budget and Finance team. The Budget and Finance team is available for support throughout this process. We'd like to thank everyone in advance for their adherence to the budget principles and time lines and the additional work required to complete this budget process successfully.

2) Budget Process Changes from Prior Years, new Two-Phased Approach, and Deadlines:

This section provides a summary of budget process highlights and describes changes from the prior year budget process.

a) Budget Guidance - changes from prior year budget process:

- i) **Budgeting Revenues:** all projected revenues (funding sources) must be budgeted in BDS by the departments' budget liaisons. Note that when budgeting all projected revenues, revenues may exceed expenses associated with the revenue source
- ii) **Budgets Compared to Forecasts:** Departments will prepare FY2017-2018 forecasts in BDS. FY2018-2019 budgets will be based on FY2017-2018 *forecasts, not budgets.*

- iii) **Budget all salary and headcount:** Departments will budget all headcount and salaries including part-time and limited appointments such as interns, students, rehired retirees, etc. All positions must have a budgeted headcount (or partial headcount), Position ID, and a salary budget
 - iv) **Equities, Promotions, Star Awards, and Stipends:** UCOP will move to budget equities, promotions, star awards, and stipends *centrally*. Funding for these salary costs will come from divisions and departments. The exact mechanism for funding and distribution of funds is in development and will be communicated with the January budgeting guidance
 - v) **Entry directly into BDS:** both the November and January submissions will be completed in BDS by the departments' budget liaisons
- b) **Two-phased approach:** This fiscal year, UCOP will implement a two-phased budgeting approach. The first phase focuses on creating clean baseline budgets and a detailed expense review. The second phase focuses on budgeting to targets, budgeting revenue, and making budget adjustments when more is known about additional factors impacting budget targets (e.g. UCOP Optimization, implementation of work related to CSA recommendations, etc.).
- i) **November Guidance and Baseline Budget Submission – includes the following:**
 - (1) Due in Budget Development System (BDS) by **December 19, 2017**
 - (2) Preliminary planning assumptions (see section 3. below)
 - (3) Entry of accurate baseline expense budgets
 - (4) Movement of items receiving bridge funding from one-time funds to the permanent operating budget as appropriate (UCOP Budget and Finance will provide guidance where this applies)
 - (5) Zero-based budgeting for the following discretionary expense line items: travel and meetings, all expense line items related to outside services (e.g. professional services, consultants, contractors, etc.), and temporary labor. Note that zero-based budgeting templates will be released by November 22, 2017
 - (6) Requests for unavoidable or known expenses increases
 - ii) **January Budget Call and Revised Submission – includes the following:**
 - (1) Revised planning assumptions and specific targets communicated.
 - (2) Revised Submissions due by **February 16, 2018** including:
 - (a) Revised expense budgets due in BDS
 - (b) Revenue budgets due in BDS
 - (c) FY2017-2018 detailed forecast due in BDS
 - (d) BDS budgeted salaries and positions reconciled with UCPath salaries and positions

3) November Preliminary Planning Assumptions

- a) **Flat expense budgets less 12 percent reduction in Travel & Meeting expense:**
 - i) All budgets must be flat in all expense areas except travel and meetings where budgets must reflect a 12 percent reduction from FY2017-2018 budgets. UCOP committed to a ten percent reduction in travel and meeting expense in May 2017 and there will be an additional two percent cost related to a new carbon offset program that must be absorbed in department budgets. Therefore, total budgets should be *less* than prior year with the reduction in travel and meetings. This planning assumption excludes UCPATH.
 - ii) Any unavoidable non-salary cost increases that cannot be absorbed must be requested on a Budget Change Form in BDS and will be reviewed. Departments will be notified at the end of the budget cycle (by June 2018) if cost increases are approved.
 - iii) *Please do not submit "wish lists". Only critical and/or unavoidable cost increases will be considered.*

- b) **Flat headcount plans:**
 - i) Headcount is expected to remain flat to current budget.
 - ii) New position requests, if any, should be funded from existing headcount and budget (no new funds, no new FTE).
 - iii) Any new key activities that cannot be offset by savings in other areas and require incremental salary funding and headcount (e.g. new grant funding received that requires staffing), must be noted and requested on a Budget Change Form in BDS for consideration. *Note: these requests will undergo rigorous review and there is a high likelihood the division or department will be asked to absorb the additional headcount.*

- c) **Salary and benefits planning:**
 - i) **Vacancy factor:** The vacancy factor for FY2018-2019 will likely increase during January budget revisions. Budget and Finance will complete Vacancy Factor analysis and include updated targets in the January guidance.
 - ii) **Merit:** A merit of up to three percent will be included initially and will be budgeted by UCOP Budget and Finance.
 - iii) **Other salary costs:** An organization-wide target percentage of total salary costs will be determined to centrally fund equities, promotions, stipends, and STAR awards. The process for budgeting and funding other salary costs will be communicated in the January budget guidance.
 - iv) **Salary savings:** Should not be relied upon to cover other expenditures as they will be swept.

- v) **Benefits costs:** Cost increases associated with benefits, retirement and other related costs will be budgeted by Budget and Finance. Baseline budgets will include a Benefit and UCRS cost increase of four percent to five percent (the exact percent increase to be validated and included in January revisions).
 - d) **Campus Assessment vs. State General Funds:** Budget all expenses currently on State General Funds (19900 funds) against the 19900 funds. UCOP is assuming a return to the Campus Assessment funding model and will make a wholesale change to the funding source in BDS on behalf of the departments when funding sources are confirmed.
- 4) **Requesting Strategic Priorities (One-Time) Funding (SPF):**
- a) **Very limited Strategic Priority (one-time) Funding:** Due to tightening of budget practices and declines in surpluses available to fund strategic priority funds, availability of strategic priority (one-time) funds will be very limited going forward.
 - b) **Requests are not approvals:** All requests for SPF (one-time) funds must be included in BDS in your baseline budget submission by **December 19, 2017**. Requests in BDS are *not considered approvals*.
 - i) Requests may be denied at any point during the budget process until the budget is approved by the Regents in May 2018.
 - ii) Requests for funding of \$100,000 or more must also go through the Major Projects & Initiatives process which includes submission of a Decision Memo. The MPI submission and accompanying Decision Memo should be submitted in FY2018-2019 for final consideration and approval.
 - iii) Requests for funding under \$100,000 require a Decision Memo. The Decision Memo should be submitted in FY2018-2019 for final consideration and approval.
 - c) **Funding on a reimbursement basis for actual expenditures:** Items budgeted at UCOP from strategic priorities funds will be funded on a reimbursement basis. Departments must track actual expenditures via a designated project code to receive reimbursement.
 - d) **More stringent UCOP practices governing strategic priorities funding:** Guidance is in development as part of the budget process recommendations related to the CSA audit which will detail what types of expenses will and will *not* be considered for funding from SPF. This new guidance will be implemented as early as February 2018. For example, budget omissions or errors will be disallowed and will be expensed to the department. This guidance will be communicated as soon as it is approved.