December 22, 2011

VICE CHANCELLOR GARY C. MATTHEWS
Resource Management and Planning
Mail Code 0057

SUBJECT: Auxiliary & Self Supporting Activities (ASSA) - Differential Income Rate Review

This letter is in response to your November 18, 2011 request to reconvene the ASSA Task Group to review UCSD’s Differential Income overhead rate. We are pleased to say that the group was able to reach consensus in recommending a slightly modified Differential Income rate that provides for added flexibility, simplifies the current process and increases the transparency in funds flow for improved campus communications.

The Task Group recommends that the campus should continue to pursue full recovery of direct and indirect costs incurred in the course of conducting business with external customers. Acknowledging that revenues should be aggressively pursued where there is a strong market and demand for campus sales and services, and that incentive and added flexibility delegated to cognizant Vice Chancellor where only basic overhead could be recovered. This basic overhead level is that which recovery may not fall below, and is set at the current minimum of:

1. 16%, which covers central administration and facilities maintenance related to on campus activities, or
2. 8%, which covers central administration related to off campus activities.

Further, the group recommends that any and all overhead recovery income above this basic level be retained at the Vice Chancellor level with discretion on its internal allocation back to generating department, PI or other priority use.

The attached brief report summarizes the issues and options considered by the members of the task group as well as the group’s recommendation for moving forward. Please feel free contact us if you have any questions or need additional information.

Sincerely,

[Signature]
Sylvia Lepe-Askari
Assistant Vice Chancellor

cc: Chancellor
Vice Chancellors
ASSA Task Group Members
EXECUTIVE SUMMARY

The Auxiliary & Self Supporting Activities (ASSA) Task Group was reconvened in November 2011 at the request of Vice Chancellor for Resource Management and Planning. Its charge was to review the current campus Differential Income overhead rate, and if necessary, make recommendations for rate change, with the goal of either affirming current rate or recommending a modified rate. The Differential Income overhead rate is the rate added to direct cost, to arrive at full cost pricing that recharge and other self-supporting activities must charge on external sales and services. Because these activities are primarily housed in campus funded and maintained space, they are subject to higher Differential rate, relative to the lower ASSA – Administrative overhead rate charged on activities that fund their own facility costs like construction, debt service, building maintenance and utilities, as well as some aspects of own administrative services (examples of the latter include Auxiliaries, Medical Group and Hospital).

Task Group membership included representatives from all Vice Chancellor units across the campus as well as the Academic Senate. The charge letter is attached at the end of this report. The Task Group reviewed the current campus Differential Income overhead rate charged on outside sales, how it is derived and its various components. It debated the rate itself and the local distribution of the overhead recovery income this business generates. A brief survey of UC counterparts was also conducted and considered in the group’s recommendation.

There was consensus among the Task Group members that the campus should pursue full recovery of direct and indirect costs incurred in the course of conducting business with external customers. There was extensive discussion of needed flexibility for units conducting such outside business, acknowledgment that revenues should be aggressively pursued where there is a strong market and demand for our sales and services, and added flexibility delegate to cognizant Vice Chancellor where only basic overhead could be recovered. This ‘basic’ overhead was reconfirmed at the current minimum of 16%, which covers general administration and facilities maintenance. As an incentive to fully recover full campus costs and pursue this business and revenue stream, the group further recommends that any and all overhead recovery income above this basic level of 16%, continue to be retained at the Vice Chancellor level with discretion on its internal use for VC and Departmental costs or other priority uses. In the rare event that this activity is housed in off-campus, non-university owned and maintained space, the basic central campus rate is adjusted down to 8%.

The general consensus of the ASSA Task Group is that this recommendation provides for both the added flexibility needed at the Vice Chancellor level to quickly respond to market demands and price setting, simplifies the current process, and increases the transparency in funds flow for improved campus communications with faculty and department administrators.

In closing, we want to extend our appreciation to all ASSA Task Group members for their active participation on this review over a fairly short timeframe.

---*****---
BACKGROUND AND ISSUES

University policy requires that Recharge and other Self Supporting activities charge full cost of conducting business when selling to external non-University customers. Recharge activities exist primarily to service internal department or campus needs, but they may also generate revenue by engaging in external sales. Service agreements are a large and growing segment of this type of campus activity. While, service agreements are normally issued by approved recharge activities for ongoing or continuous sales of goods and/or services, they are also issued by non-recharge activities. Recharge and other self supporting activities are supported by campus administrative offices and are generally housed in campus funded and maintained space, so do not pay directly for their own facilities costs like debt service, building maintenance, and utilities. Thus, as University policy requires, and prudent business practice necessitates, an appropriate level of campus overhead should be incorporated into the total price charged to external customers. This is accomplished by adding Differential Income overhead rate to the direct cost charged, with some portion remitted back to the campus.

UCSD’s Differential Income overhead rate is derived from the heavily scrutinized sponsored rate negotiated with the Department of Health and Human Services (DHHS), less four components; equipment depreciation is excludes as it is already included in direct cost recharge rates; and sponsored project administration, student services administration, and libraries are excluded because they are mostly deemed to not directly benefit external sales. Table A below provides a breakdown of the Differential Income rate for San Diego as well as a those UC campuses that responded to a brief survey conducted to inform this review.

<table>
<thead>
<tr>
<th>Rate Components</th>
<th>San Diego</th>
<th>Davis</th>
<th>San Francisco</th>
<th>Los Angeles</th>
<th>Irvine</th>
<th>Berkeley</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Adjusted Research Rate</td>
<td>Other Sponsored Activities</td>
<td>Research Off-Campus Rate</td>
<td>Research Rate pending review</td>
<td>Other Sponsored Activities</td>
<td>Other Sponsored Activities</td>
</tr>
<tr>
<td>General Admin</td>
<td>5.5</td>
<td>5.0</td>
<td>7.0</td>
<td>3.8</td>
<td>4.3</td>
<td>7.0</td>
</tr>
<tr>
<td>Department Admin</td>
<td>16.2</td>
<td>14.5</td>
<td>16.5</td>
<td>17.9</td>
<td>0.0</td>
<td>8.5</td>
</tr>
<tr>
<td>Student Services Admin</td>
<td>0.0</td>
<td>0.0</td>
<td>2.2</td>
<td>0.0</td>
<td>0.0</td>
<td>1.5</td>
</tr>
<tr>
<td>Sponsored Projects Admin</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Building Depreciation</td>
<td>5.3</td>
<td>2.4</td>
<td>0.3</td>
<td>5.2</td>
<td>1.3</td>
<td>2.5</td>
</tr>
<tr>
<td>Building Interest</td>
<td>4.3</td>
<td>1.3</td>
<td>0.0</td>
<td>3.6</td>
<td>1.8</td>
<td>1.1</td>
</tr>
<tr>
<td>Equipment Depreciation</td>
<td>0.0</td>
<td>1.5</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>1.1</td>
</tr>
<tr>
<td>Operation &amp; Maintenance</td>
<td>14.1</td>
<td>5.3</td>
<td>0.0</td>
<td>14.2</td>
<td>5.4</td>
<td>8.2</td>
</tr>
<tr>
<td>Library</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>1.8</td>
<td>1.1</td>
</tr>
<tr>
<td>(rounding)</td>
<td>(0.4)</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td></td>
<td><strong>45.0</strong></td>
<td><strong>30.0</strong></td>
<td><strong>26.0</strong></td>
<td><strong>44.7</strong></td>
<td><strong>14.6</strong></td>
<td><strong>33.0</strong></td>
</tr>
</tbody>
</table>

1. San Francisco is currently reviewing their DI rate and is planning to incorporate the Facilities component into their charge rate similar to San Diego.

2. Los Angeles currently does not charge DI on outside sales. However, as of last month, LA decided to establish a DI rate based on the negotiated organized research rate.

3. 100% of DI is retained by central administration.

Source: Financial Analysis Office survey conducted and finalized on December 16th, 2011.
Historically, the biggest issue with Differential Income overhead recovery on the campus was non-compliance with campus policy. Policy requires that Departments collect and remit differential income, but the majority of departments either do not properly price external sales and services to recover full cost including overhead, or are collecting but do not properly remit overhead back to the campus. In 2010/11, the ASSA implementation team closely monitored the outside sales activities to ensure compliance with campus and UC overhead policies. For activities that did not remit any overhead, the ASSA implementation team assisted departments with their Differential Income calculations and processing of transactions.

Another issue, or complexity, with the current Differential Income overhead rate is due to current policy that requires internal distribution of overhead recovery income such that 35% of the current Differential rate be remitted to central campus (effectively ~16%), and the remaining 65% retained by the cognizant Vice Chancellor/Department generating the revenue (effectively 29%). This allocation model proved to be difficult to follow, implement and explain to faculty and departmental business officers who were either misinformed or had inaccurate perception that the entire recovery was remitted and retain by central campus.

In response to the above concerns, the ASSA Task Group, inclusive of all Vice Chancellor area Financial Officers, was reconvened to review the campus Differential income overhead rate, and if necessary, make recommendations for rate change. The group met twice over the period of a month and discussed issues noted above and possible options at outlined below.

**OPTIONS FOR CONSIDERATION**

The group discussion and options proposed for consideration were generally focused on increasing the level of Vice Chancellor flexibility in price setting while establishing a base threshold below which overhead rate cannot fall below, increasing unit incentives for generating revenue, transparency in funds flow, simplifying the allocation model, and lastly, setting principles to drive future rate adjustments. There was some concern raised with regard to potential risk posed if units do not fully recover overhead costs from external users, at least at the same rate as that recovered from sponsored activity relative to OMB Circular A-21. However, no consensus was reached on such risk and most importantly, members did agree and recognize the importance of full recovery of direct and indirect costs, and the opportunity to charge market prices and aggressively pursue business where there is a strong market and demand for campus sales and services.

- **Option 1:** This option is similar to current policy, however, a base rate A is established below which the overhead recovery cannot fall below. This portion represents the required minimum to be remitted to central campus as revenues are received. This base is set at 16%, which is derived from the current 35% campus share of the 45% On-campus overhead rate and rounded for simplicity. The A base rate would be adjusted down to 8% for Off-campus activity.

  A secondary B portion would be set as standard campus overhead as reflected in Table A on preceding page so that department staff can easily understand parameters within which they should operate in setting their external sales pricing. This secondary B portion would have added Vice Chancellor flexibility in adjusting higher relative to market demand, or lower as deemed appropriate with full benefit and risk borne by Vice Chancellor.
For example: If market demand is such that price can be set at a rate that includes a 50% overhead on direct sales and service costs; then the first 16% would be remitted to campus and the Vice Chancellor/unit would retain all recovery above this base, or 34% in this case.

- **Option 2:** Similar to option 1, however the base rate A below which minimum overhead recovery cannot fall below is more directly tied to the sum of the General Administration (5.5%) and Operation and Maintenance of Plant (14.1%) components of either the negotiated or the calculated costs as reflected in table A (20% - 21% total). Any recovery above this base would remain at Vice Chancellor discretion. Similar to option 1, this would simplify the process and provide an incentive to the unit to fully cost activities and set pricing at what market will bear relative to supply and demand.

However, the Task Group members were most supportive of existing rates in option #1 rather than increasing the amount of overhead their departments remit to the central campus. This approach may be applied going forward as the campus sets to negotiate its new sponsored rate to go into effect after 2013/14 when current agreement ends.

- **Option 3:** To take simplicity methodology even further, a flat rate of 20% was considered to support central administration and facilities maintenance, with anything above this level retained at Vice Chancellor level. For similar reasons as option #2, this option was not endorsed.

**RECOMMENDATIONS**

The general consensus of the ASSA Task Group was to recommend Option 1. The group felt strongly about the importance of setting pricing on outside sales and services such that full direct and indirect costs are included, and where possible, most aggressively pursue business where there is a strong market and demand, as well as opportunity for net positive revenue flows.

Further, the group recommends that campus policy and Blink documentation be updated quickly; that basic campus training be provided to more quickly disseminate information, clarify current misperceptions, respond to questions and improve overall campus policy compliance; and that monitoring of this activity continue, along with a refocused effort and support for automating recovery process.

In closing, we want to extend our appreciation to all ASSA Task Group participants for their active involvement on this review:

- DOUG BENNETT, Marine Sciences
- RON ESPIRITU, Health Sciences
- MARIANNE GENERALES, Research Affairs
- BRIAN GREGORY, Resource Mgmt & Planning
- THEODORE GROVES, Academic Senate
- DIANE HAMANN, Academic Senate
- ROBERT HANNAHS, Campus Budget Office
- JOHN HUGHES, Student Affairs
- DARRYL JAMES, Financial Analysis Office
- JUDY JOHNSON, External & Business Affairs
- SYLVIA LEPE, Campus Budget Office
- DEBBIE MCGRAW, Academic Affairs
- THEODORE GROVES, Academic Senate
November 18, 2011

DOUG BENNETT, Marine Sciences
RON ESPIRITU, Health Sciences
MARIANNE GENERALES, Office of Research Affairs
BRIAN GREGORY, Resource Management and Planning
DIANE HAMANN, Academic Senate
DARYL JAMES, Financial Analysis Office – Staff Support
JUDY JOHNSON, External and Business Affairs
SYLVIA LEPE-ASKARI, Campus Budget Office – Facilitator
DAVE MILLER, Representative from Academic Senate
DEBBIE MCGRAW, Academic Affairs
ED SPRIGGS, Student Affairs

SUBJECT: Reconvene Auxiliary & Self Supporting Activities (ASSA) Task Group

I would appreciate your participation on the reconvened ASSA Task Group to conduct a focused review of the current campus Differential Income overhead rate, and if necessary, make recommendation(s) for rate change.

Most of you were part of the ASSA task group that developed the current Administrative Overhead rate, were part of the initial ASSA tiger team or are Financial Officers for your Vice Chancellor area, and thus have the policy background that is required for continuity and to ensure timely completion. The goal is to either affirm the current campus rate or recommend a sound modified rate by mid-December, so that campus leadership can make a final and well informed decision by the end of this December.

Sylvia Lepe-Askari will help facilitate the work of this group, with staff from Financial Analysis Office providing staff support. Her office will contact you shortly to schedule a few working meetings between now and mid-December, when you are asked to submit your final recommendation. I apologize for the short timeline and do understand the extra work this requires of you, on top of the many demands on your time already. Please know that the campus leadership greatly appreciates your investment in this important campus effort.

Sincerely,

Gary C. Matthews
Vice Chancellor

cc: Chancellor
Vice Chancellors