

2014 BRINGING ADMINISTRATORS TOGETHER CONFERENCE

Establishing a Financial Reserves Policy

April 1, 2014

11:30 a.m.

UIC UNIVERSITY OF ILLINOIS
AT CHICAGO

UIC

Lincoln Hall

707 South Morgan Street

Workshop Presenter

Janet A. Parker

Associate Chancellor & Vice Provost for
Budget and Resource Planning

japarker@uic.edu

312-355-4565

Please ...

- Turn off cell phones.
- Avoid side conversations.
- Feel free to ask questions throughout the presentation *although some may need to be deferred to the end if time does not allow.*
- Sign the attendance roster.
- Complete the evaluation at the end of the workshop.

Topics – Workshop Objectives

The session will provide attendees an overview & understanding of the following topics:

- What are financial reserves?
- Challenges & issues
- Types of reserves
- What level of reserves is appropriate?
- Budgeting reserves
- Financial reserves policies – university practices

Financial Reserves

- **Fiscally sound institutions maintain appropriate levels of reserves for:**
 - Unanticipated / uninsured catastrophic events
 - Unforeseen legal obligations and costs
 - Infrastructure or major business systems failures
 - Business continuity
 - Revenue shortfalls or expenditure gap coverage

Financial Reserves

- **Fiscally sound institutions maintain appropriate levels of reserves to:**
 - Provide debt management & issuance foundation
 - Fund depreciation: facility/equipment renewal & replacement
 - And, in Illinois, allow the university's payroll & bills to be paid
- **Typically, a discrete subset of net liquid assets**

What type of assets qualify?

- Unrestricted
- Unencumbered
- Not tangible (*physical*) or intangible (*copyrights, patents*) assets
- Not endowment related
- Basically, unrestricted, uncommitted, nonrecurring, aka “available cash”

Challenges & Issues

- How to address criticism for ‘hoarding funds’
- Setting expectations & criteria for how and when these funds should be used
 - Difference between cash balances & designated reserves
- Determining the appropriate amount of reserves & rationale
- Establishing a policy framework

Negative Press

Ohio senator eyes \$2.9B in university assets (May 2011)

- “Ohio's public universities have combined cash reserves nearing \$3 billion, a figure that's raising new questions about their requests for tuition increases and state aid.”
- “Ohio State University leads the pack with \$1.2 billion in a type of reserves known as *unrestricted net assets*, according to a document compiled by Senate Finance Chairman Chris Widener Eleven more universities or colleges are holding more than \$50 million in such assets.....”

http://boston.com/news/education/higher/articles/2011/05/03/ap_ohio_senator_eyes_29b_in_university_assets/

Negative Press

- **Scottish universities have 'record cash reserves', EIS union research suggests** (February 2014)
 - A Universities Scotland spokesman said reserves could not "be easily used to fund pay."

<http://www.bbc.com/news/uk-scotland-26035516>

Negative Press

- **Outrage grows as University of Wisconsin System admits it 'did not draw attention' to cash** (April 2013)
 - \$648 million in reserves is spread over hundreds - perhaps thousands - of accounts

Read more from Journal Sentinel:

<http://www.jsonline.com/news/education/outrage-grows-as-uw-admits-it-did-not-draw-attention-to-cash-r59lh2e-204159081.html#ixzz2uT30seHA>

How much cash should we have?

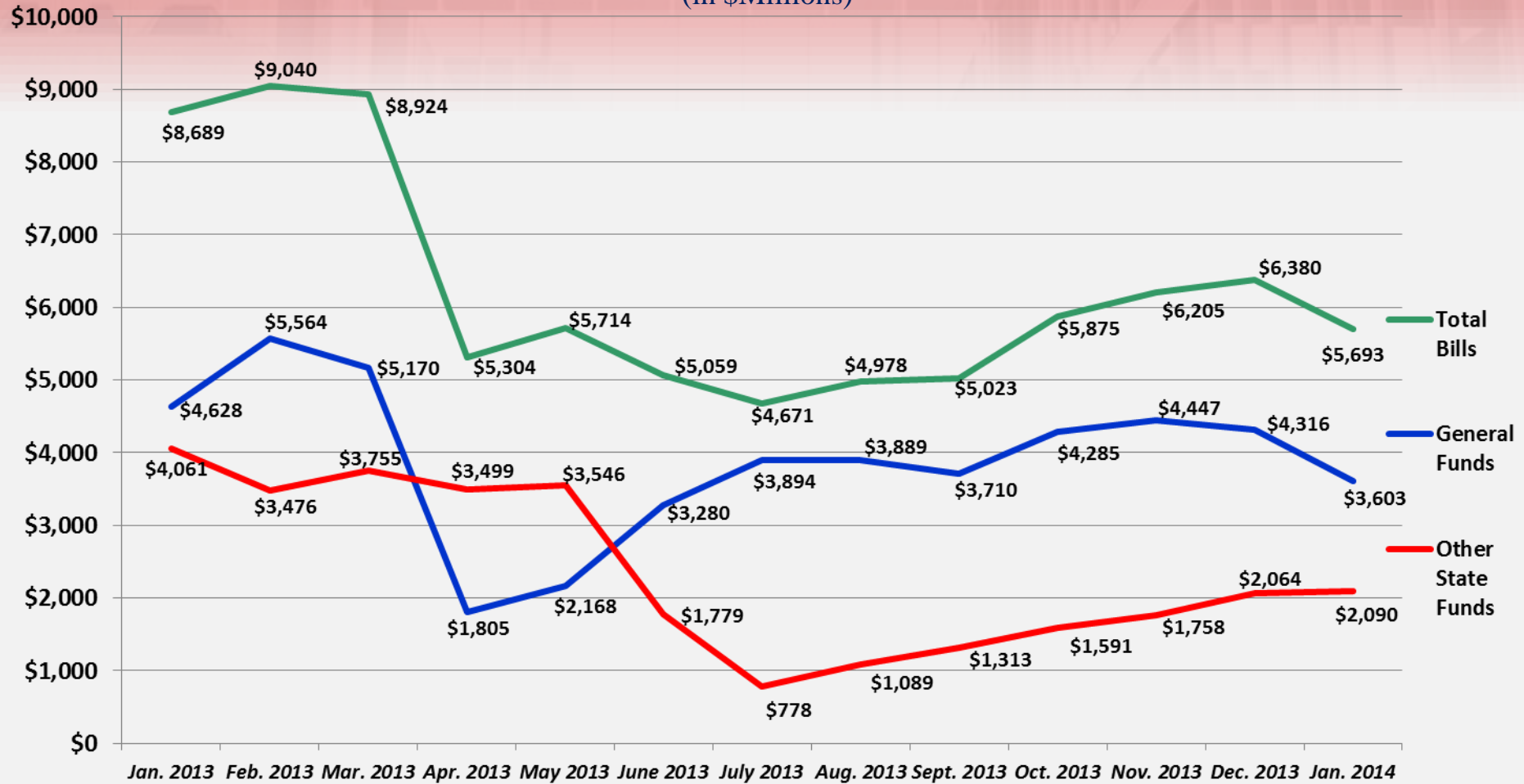
- Liquidity
 - The University of Illinois has a consolidated financial reporting structure
 - Total UI cash provides liquidity for the entire system
- Who's Money is it Really?
 - UA, UIUC & UIS vs. UIC held cash
 - **Campus central funds**
 - **Auxiliary Facility System**
 - **Unit/College funds**
 - **Department**
 - **PI**

Governor's Office of Management and Budget

Bills Backlog – By Fund

January 2013 through January 2014

(in \$Millions)



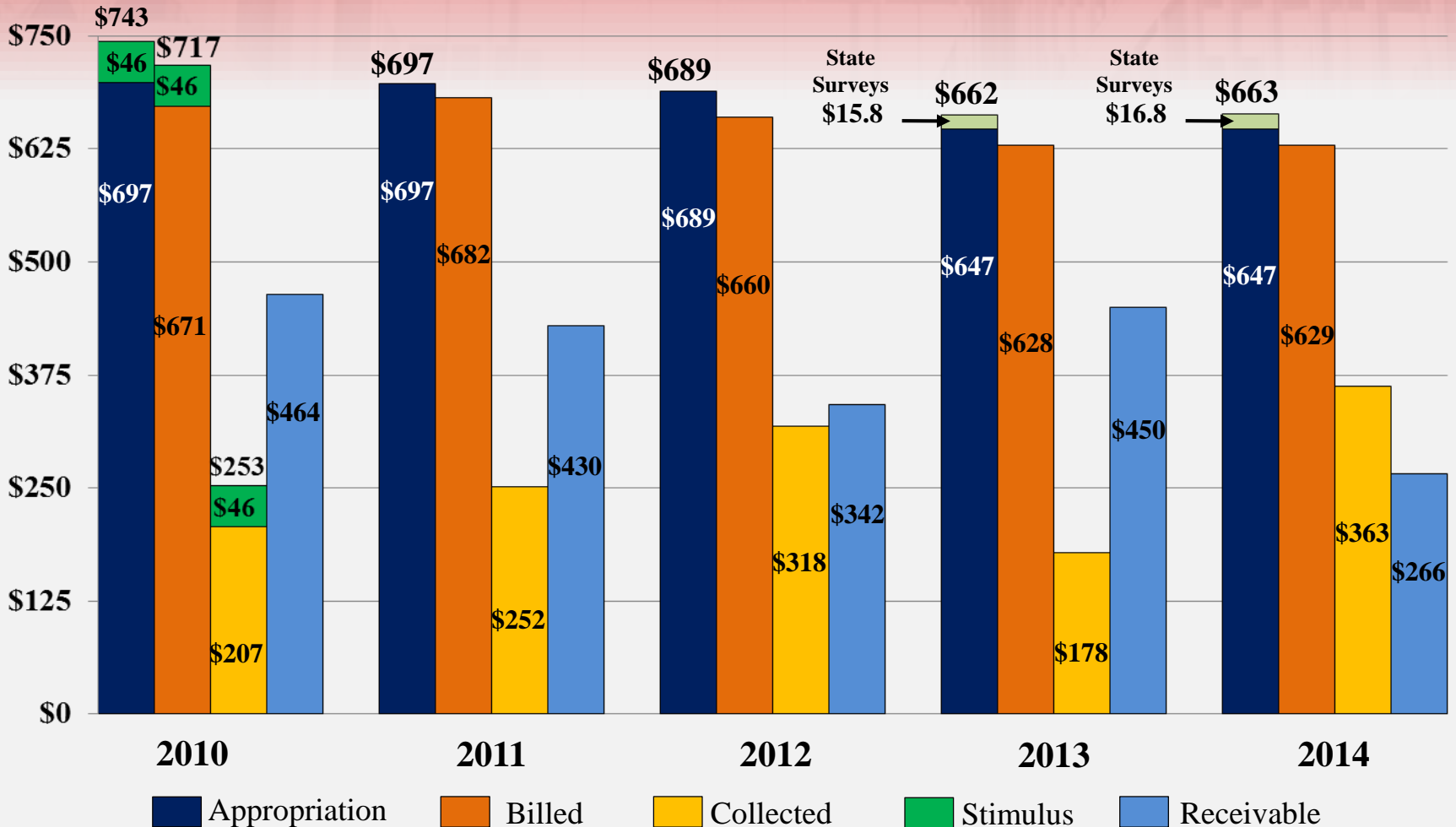
Source: Governor's Office of Management and Budget (including data from the Illinois Office of the Comptroller) February 15, 2014

*Totals do not include Medicaid bills in-process at the Dept. of Healthcare and Family Services (HFS) from July '13 forward because they are being processed to the Comptroller in under 30 days, and the Department has sufficient FY14 appropriations to cover them. GRF and related fund Medicaid bills in process at HFS as of Jan. 31 total about \$800 million.

State Appropriation Revenue

Billings and Collections through March 31, 2014

Dollars in Millions

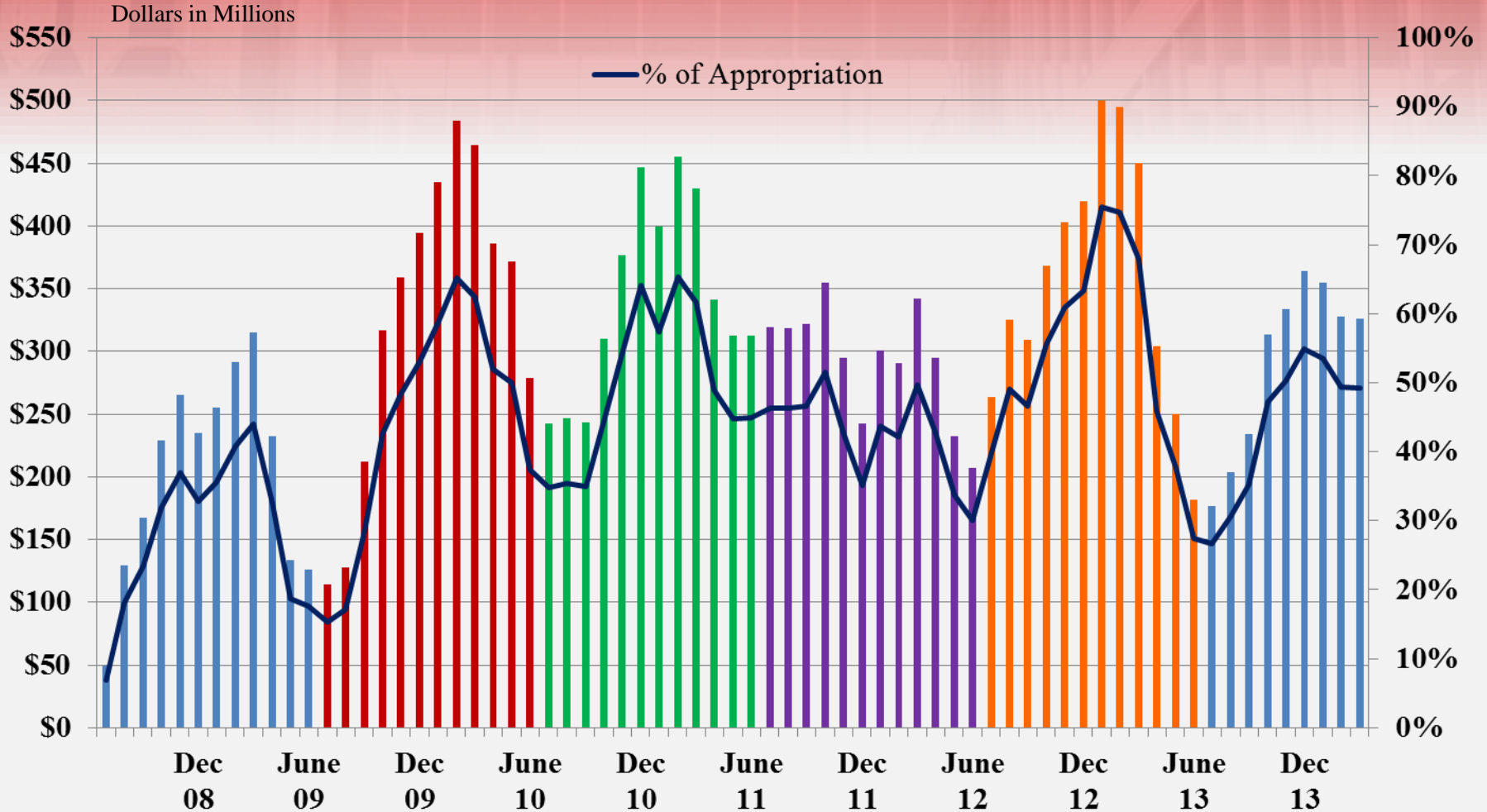


FY10 appropriation includes \$45.5 million of federal stimulus funding.

UI Month End GRF Receivable & Percent of State Budget

Fiscal Year 2009 through Fiscal Year 2014

As of March 3, 2014



Receivables as of June 30th for each of the following fiscal years were: 2009 (\$125.9M), 2010 (\$278.5M), 2011 (\$312.7M), 2012 (\$206.7M), 2013 (\$181.4M).

Primary Reserve Ratio

- Measures institutional financial strength
 - how long could the university function using expendable reserves?

Expendable net assets

Total Expenses

- Expendable net assets = Total net assets *minus* permanently restricted net assets *minus* Property, Plant & Equipment, net + Long-term Debt

Primary Reserve Ratio

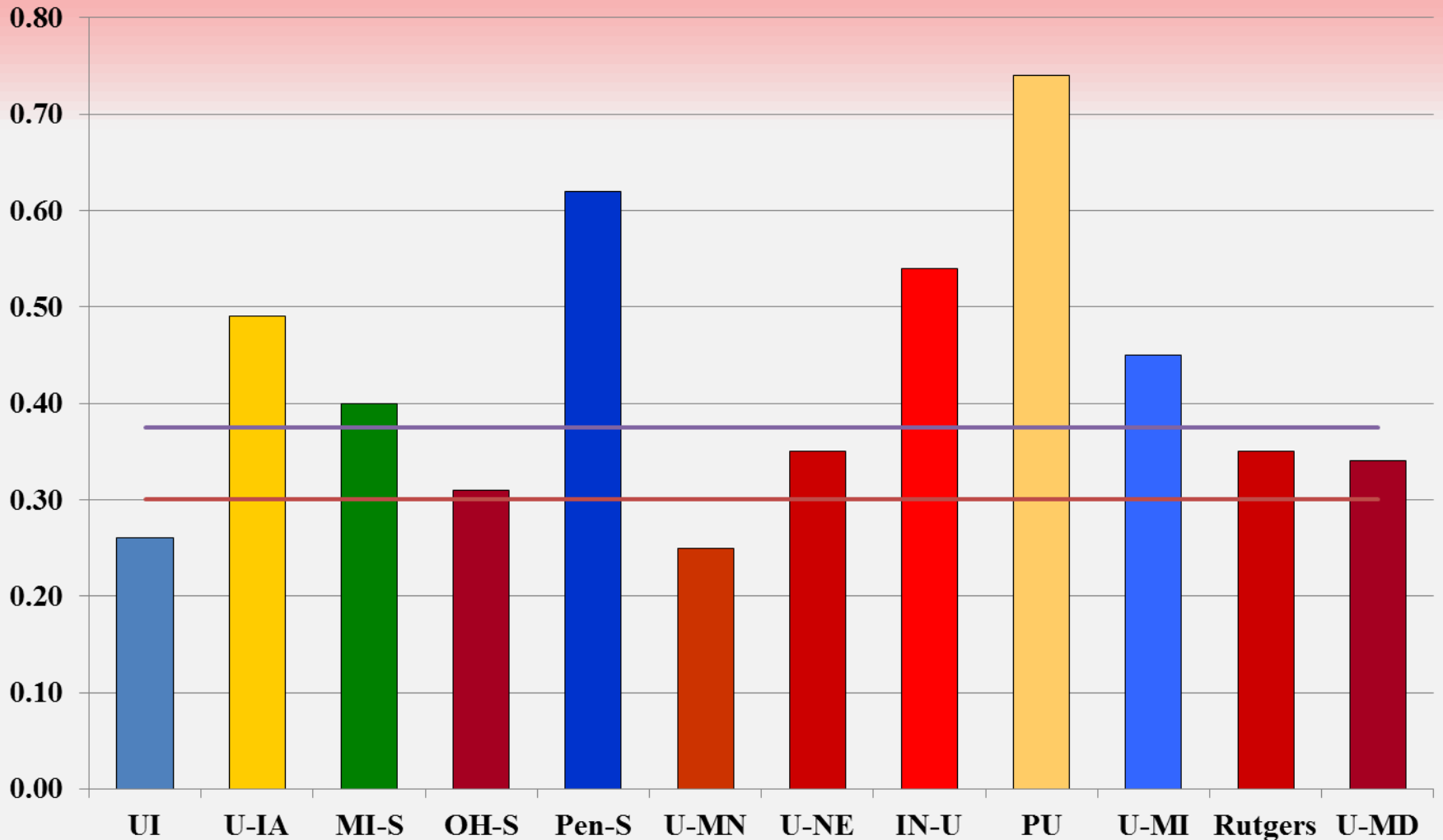
- Key items that impact the PRR –
 - Debt principal payments
 - Use of unrestricted net assets to fund capital construction
 - Operating results
 - Endowment returns
 - Total operating expenses

University Reserve Requirements

- NACUBO recommends at least 25% of the unrestricted operating budget - enough to sustain operations for 3 months
- 40% - very solid = 4.8 months
- Over 50% - high = 6 months

Big Ten Comparison

Unrestricted Financial Resources-to-Operations



Univ of WI System = 25%

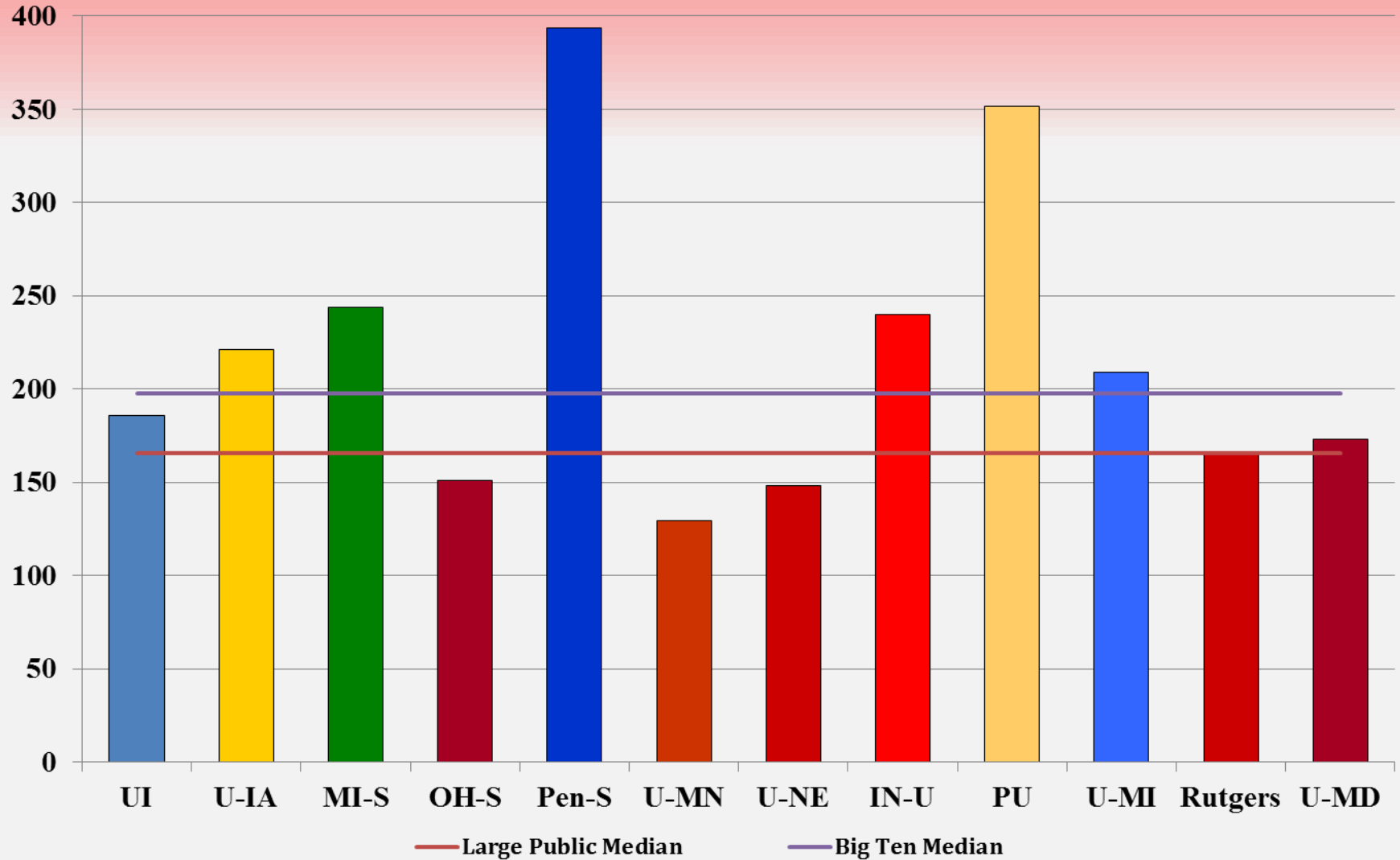
*Source: Moody's Investor Service as of 2/18/2014.

Days of Cash On Hand

- Empirical norm = 90 days
 - Benchmarks have not been established
 - Arbitrary to use a 3 month cash operating reserve for all public sector entities
 - Higher education typically requires higher levels
 - Self-supporting units have greater needs; available data is not equal to a standard
 - Hospitals (2012: average nonprofits had 165 days of cash on hand (4.5 months) with a cash-to-debt ratio of 117.7%)
 - Auxiliary Enterprises (Moody's assigns A-1 bond rating for \$39.4M of new debt to Missouri State University Auxiliary; 203 days cash on hand (6.67 months))

Big Ten Comparison

Days Cash on Hand



*Source: Moody's Investor Service as of 2/18/2014.

Balancing Cash Requirements with Formally Designated Reserves

- University Administration must assure adequate liquidity (cash on hand) to fund day-to-day operations
- Reserves are a subset of overall liquidity
- Campus (both central and unit level) must determine the amount of discretionary funds needed for strategic priorities or capital improvement projects.

Types of Reserves

– Operating Reserves

- Revenue fluctuation / rate stabilization
- Planned future operations / debt reduction

– Capital Reserves & Debt Service Reserves

- Equipment replacement
- Deferred maintenance and Repair and Replacement

– Contingency Reserves

- Unplanned events
- Insurance deductibles
- Risk contingency
- Business continuity

What is right for your organization?

- Needs vary based on organizational complexity.
- Items to consider:
 - Mission and long-term plans
 - Structure
 - Corporate oversight
 - Size of workforce
 - Stability of revenue streams
 - Competitiveness
 - Investment in physical plant
 - Depends on age and condition
 - Debt structure
 - Current & future commitments
 - Self-insurance requirements

University of Illinois Auxiliary Facilities System

- Established by Illinois Statute:

<http://www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=1107&ChapterID=18>

- Authorizes:

- Repair & Replacement Reserve
- Equipment Reserve (*may not exceed 20% of the book value of the movable equipment of the system*)
- Bond & Interest Sinking Fund & Debt Service Reserve (*equal to the maximum annual net debt service*)
- Development Reserve

Reserve Requirements at the Unit Level

- Central needs versus unit needs will vary
 - Not all units are created equally
 - Not all units share similar risks
 - Level of risk assumed centrally versus unit level
- UIC's practice on what facility needs are funded centrally vs. at the unit adds uncertainty
 - Most units operate on the "take care of ourselves" premise
- Critical for auxiliary enterprises and certain self-supporting entities with fixed costs

Unit Reserve Rationale

1. What types of reserves may apply to the unit's mission and campus operational model?
2. Analyze & quantify potential financial risks
 - Are there means to mitigate these costs through other strategies, e.g. purchase insurance?
3. Establish target reserve levels / goals
 - Benchmarks are only so useful; each institution and sub-sector has different risks & requirements

Equipment Replacement Reserves

- Obtain property accounting records (with age info)
- Determine assets that will require replacement
 - *Do not include acquisition of equipment that does not currently exist in the unit*
- Define replacement goal in years for each asset
 - *Normally based on age or obsolescence timeframe, or*
 - *Use 20% of book value (equipment will be replaced every 5 years)*
- Project replacement costs

Equipment Replacement Reserves

- Determine annual reserve targets by dividing replacement costs by the number of years before replacement is required
- Each fiscal year-end, transfer up to the target amount to Plant Reserves
- Create an Excel spreadsheet to track changes to annual reserve targets:
 - As equipment is purchased and added to or removed from the list
 - When reserve amounts are added and or expended
 - Serves as audit trail & justification for the reserve

Elements of a Reserves Policy

- Clearly articulated purpose for the reserve
- Responsibilities for approving the reserve level, purpose & usage
- Process for establishing, monitoring, using & adding to the reserve
- Approval for using reserves for purposes other than the original intent, e.g. to deal with budget emergencies
- Published and transparent
- Communicated & consistently applied

Reserve Policies

General Reserves -

- Minnesota State Colleges & Universities:

<http://www.mnscu.edu/board/procedure/510p1.html>

- SUNY:

http://www.suny.edu/sunypp/documents.cfm?doc_id=727

- University of Wisconsin:

<http://profs.wisc.edu/wp-content/uploads/2013/10/October-Regent-BF-reserves-policy.pdf>

Equipment Replacement -

- University of Minnesota:

<http://policy.umn.edu/Policies/Finance/Budget/EQUIPMENTRESERVES.html>

- Virginia Commonwealth University:

<http://www.controller.vcu.edu/uco/Repair-ReplacementReservePolicy.pdf>

Auxiliary Enterprise Reserve Policies

- Oregon State University:

<http://oregonstate.edu/fa/manuals/fis/517>

- California State University, Long Beach:

<http://www.csulb.edu/divisions/students/asi/administration/policies/Policy%20on%20Reserves%20-%20Associated%20Students.pdf>

- University of Oklahoma:

<http://www.ou.edu/controller/fss/policies/AE.pdf>

Questions / Concerns?