



Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873
Email: fiscal.bureau@legis.wisconsin.gov • Website: <http://legis.wisconsin.gov/lfb>

May 23, 2013

Joint Committee on Finance

Paper #675

PR Appropriation Balances (UW System)

CURRENT LAW

In general, the UW System's program revenue (PR) appropriations are continuing appropriations that allow the UW System to carry balances from one year to another. The Board of Regents is prohibited from accumulating auxiliary reserve funds of more than 15% of the previous fiscal year's total revenues from student segregated fees and auxiliary operations funded by students fees unless the reserve funds are approved by the Secretary of the Department of Administration (DOA) and the Joint Committee on Finance. There are no other current law limits on the amount of PR balances the UW System may accumulate.

GOVERNOR

No provision.

DISCUSSION POINTS

1. Maintaining operating balances is a common practice across both the private and public sectors. These funds can be drawn down to support operations in the case of a shortfall of revenues or other emergencies and to provide start-up funds for new programs. The level of UW System operating balances is a matter of policy that could be appropriately decided by the Board of Regents, to whom the statutes grant primary governance responsibility for the UW System, the state Legislature, or both. In crafting a policy regarding operating balances, policymakers should balance the UW System's ongoing need to manage its finances with the public policy goal of keeping higher education affordable for state residents by controlling tuition increases.

2. Current and prior law allows the UW System to accumulate balances related to its program revenue (PR) appropriations. Under 2011 Act 32, most of the UW System's PR appropriations were collapsed into five PR appropriations. Prior to 2011 Act 32, UW PR

appropriations included: academic student fees (tuition); federal aid; auxiliary enterprises; gifts and donations; federal aid -- loans and grants; general operations receipts; federal indirect cost reimbursement; auxiliary enterprises -- UW-Madison intercollegiate athletics; services provided to the UW Hospitals and Clinics Authority; extension student fees; State Laboratory of Hygiene; gifts and grants -- UW-Madison intercollegiate athletics; and other smaller appropriations. Although most of these appropriations were deleted under 2011 Act 32, the UW System has continued to internally track program revenues based on prior law fund codes allowing for comparisons to be made between 2011-12 and prior fiscal years.

3. The UW System's program revenue (PR) appropriation balances have increased significantly during the past ten years. Table 1 shows the balance of the academic student fees (tuition), extension student fees appropriations and the total balance of all UW System PR appropriations (including the tuition and extension student fees appropriations) on June 30 of each fiscal year from 2002-03 to 2011-12. As shown in the table, the tuition and extension student fees appropriation balances increased more than six-fold over that period of time from \$70.5 million on June 30, 2003, to \$459.5 million on June 30, 2012. Over the same period of time, the UW System's total PR appropriation balance increased more than three-fold, from \$287.1 million on June 30, 2003, to \$1,045.2 million on June 30, 2012.

TABLE 1

**PR Appropriation Closing Balances
2002-03 to 2011-12
(\$ in Millions)**

	<u>Tuition</u>	<u>Extension Student Fees</u>	<u>Tuition and Extension Fees</u>	<u>Total PR Balances</u>
2002-03	\$62.1	\$8.4	\$70.5	\$287.1
2003-04	63.0	12.9	75.9	232.3
2004-05	87.6	10.5	98.1	268.2
2005-06	109.3	13.6	122.9	315.2
2006-07	145.5	14.0	159.5	405.9
2007-08	161.2	20.7	181.9	443.6
2008-09	212.8	22.9	235.7	563.7
2009-10	277.5	33.2	310.7	649.6
2010-11	393.3	38.5	431.8	836.8
2011-12	414.1	45.4	459.5	1,045.2

4. Similar to public and private entities, UW institutions maintain operational balances as a means of managing risk. It could be argued that UW institutions have increased their operational balances over the past decade in response to an increase in perceived risks. In the past, the primary risk faced by institutions was an unexpected decline in enrollment. Lower enrollments result in lower tuition revenues and could mean that an institution does not have enough revenues to fund its costs in a particular year.

5. UW leaders have stated that additional reductions in GPR funding are currently the most significant risk faced by UW institutions. Four of the last five biennial budgets have included significant GPR funding reductions for the UW System: the 2003-05 biennial budget reduced funding for the UW System by \$250,000,000 over the biennium; the 2005-07 biennial budget reduced funding for the UW System by \$90,000,000; the 2009-11 biennial budget reduced funding for the UW System by \$120,061,600; and the 2011-13 biennial budget reduced funding for the UW System by \$250,250,000. In addition, the UW System has been required to lapse additional funds to the general fund over the last three biennium including: \$16.3 million in 2007-08, \$36.9 million in 2008-09, \$44.4 million in 2009-10, \$46.1 million in 2011-12, and a proposed \$19.6 million in 2012-13. UW officials have suggested that the increase in the UW System's PR appropriation balances is the result of multiple layers of managers accumulating moneys in anticipation of future GPR reductions and required lapses. Other risks faced by the UW System may include a reduction in private donations or trust fund income due to an economic downturn or other factors.

6. The UW System has also stated that higher PR appropriation balances may be appropriate given that more of their programs are now funded on a cost recovery basis. Cost recovery programs are funded entirely by tuition and fee revenue and do not receive any GPR funds. The UW System has also said that a substantial portion of its PR appropriation balances have been accumulated to fund new programs including the Schools of Public Health and Freshwater Sciences at UW-Milwaukee, an expansion of the School of Engineering at UW-Madison, the flexible option degree program, and other programs related to the UW System's growth agenda.

7. While it is easy to understand why institutional managers would be motivated to accumulate fund balances, it is more difficult to understand precisely how they did so during a period of reduced state support. In particular, the tuition revenue appropriation balance increased by \$20.8 million in 2011-12, the same year in which GPR funding for the UW System was reduced by \$125.1 million and the UW System was required to fund a \$46.1 million lapse.

8. Table 1 shows that the tuition and extension student fees appropriations balances totaled \$459.5 million of June 30, 2012, or 44% of the UW System's total PR appropriation balances. While it may be desirable for the UW System to accumulate PR appropriation balances as a means of managing risk and funding new programs, the state has an interest in keeping tuition rates low as a means of maintaining affordability for resident students. The Board of Regents increased base resident undergraduate tuition by 5.5% in each year from 2007-08 to 2012-13. Given that the tuition appropriation balance increased in each of those years, one could argue that the tuition increases approved by the Board of Regents were higher than were necessary to fund the UW System's ongoing operations.

9. Data on student indebtedness shows that the percentage of students who graduate with student loan debt and the amount of that debt has increased in recent years indicating that many resident students and their families have not been able to afford these tuition increases. Based on data from the UW System, 67% of resident undergraduates who completed a bachelor's degree in 2006-07 graduated with some student loan debt; student loan debt averaged \$21,104 for those students. By 2011-12, the percentage of resident undergraduates who graduated with debt had

increased to 72% and the average amount of debt those students had increased to \$28,002. Base resident undergraduate tuition and average student debt have increased by approximately the same amount over that time period. From 2006-07 to 2011-12, base resident tuition increased by a total of 30.7% while average student debt increased by 32.7%.

10. The UW System has stated that a substantial portion of its tuition revenue appropriation balance was generated by increases in enrollments as opposed to increases in tuition. Enrollments did increase significantly in many of the years shown in Table 1. For example, from 2008-09 to 2009-10, total enrollment increased by 2.48%. Based on this increase, approximately \$24.7 million of the total increase in tuition revenue of \$95.7 million may have been generated by increases in enrollment. The remainder of the increase in tuition revenue (\$71.0 million) may be attributable to the 5.5% increase in resident undergraduate tuition, base tuition increases for other students, the implementation of differential tuitions at certain institutions, and other factors. Tuition revenues attributable to unanticipated increases in enrollment are generally not spent in the year in which they are generated, thus increasing the tuition revenue appropriation balance.

11. When discussing the level of net assets shown in the UW System's Annual Financial Report with the Board of Regents, UW System staff often use a calculation referred to as the "primary reserve ratio." The "primary reserve ratio" is calculated by dividing the sum of the UW System's unrestricted net assets and expendable restricted net assets by its operating expenses. (The UW System's net assets are reported using generally accepted accounting principles (GAAP) while the PR appropriation balances are reported on a budgetary basis.) On June 30, 2012, the UW System's unrestricted and expendable restricted net assets totaled \$1,134.4 million while its operating expenses for the previous fiscal year were \$4,482.9 million resulting in a "primary reserve ratio" of 25.3%. By comparison, the UW System's "primary reserve ratio" was 15.4% in 2007 based on information provided in the UW System's Annual Financial Report for 2007.

12. The National Association of State College and University Business Officers (NACUBO) recommends that institutions maintain a "primary reserve ratio" of 40%. UW System Administration staff have cited the NACUBO recommendation when discussing the UW System's Annual Financial Report at Board meetings, but have said that it is not a target. To provide additional context for UW System's "primary reserve ratio," UW System staff have provided financial information for peer universities and university systems. Financial information was collected for additional universities and university systems by this office. Table 2 shows the total available net assets (the sum of the unrestricted net assets and the expendable restricted net assets), operating expenses, and the "primary reserve ratio" for the UW System and 12 public university systems. Tables 3 and 4 show the same data for UW-Madison, UW-Milwaukee, and selected peer institutions. Except where noted, the data shown is for fiscal year 2012.

TABLE 2**Financial Information for Selected Public University Systems**

	Total Available <u>Net Assets</u>	Total <u>Expenses</u>	Primary <u>Reserve Ratio</u>
University of Texas System	\$12,988,541,000	\$13,735,388,000	94.6%
University of Missouri System	1,768,244,000	2,726,076,000	64.9
University of Colorado System*	1,127,439,000	2,539,249,000	44.4
University of Illinois	1,640,290,000	4,871,109,000	33.7
University of Massachusetts System	867,501,000	2,654,060,000	32.7
California State University System	1,988,023,000	6,253,631,000	31.8
Minnesota State Colleges & Universities*	547,446,000	1,903,985,000	28.8
University of Wisconsin System	1,134,389,000	4,482,910,000	25.3
University of California System	5,404,834,000	26,293,792,000	20.6
Pennsylvania State System of Higher Education	165,771,000	1,904,430,000	8.7
City University of New York System	257,547,000	4,138,727,000	6.2
University of Georgia System	-348,889,000	6,916,054,000	-5.0
State University of New York	-1,591,300,000	9,960,335,000	-16.0

* Information is for fiscal year 2011.

TABLE 3**Financial Information for UW-Madison and Selected Peer Institutions**

	Total Available <u>Net Assets</u>	Total <u>Expenses</u>	Primary <u>Reserve Ratio</u>
University of California-Berkeley	\$2,695,410,000	\$2,300,143,000	117.2%
Purdue University	2,019,304,000	1,860,009,000	108.6
Pennsylvania State University	4,721,860,000	4,587,163,000	102.9
University of Texas-Austin	2,503,865,000	2,442,851,000	102.5
University of Michigan	5,809,798,000	5,887,158,000	98.7
University of North Carolina-Chapel Hill	1,887,000,000	2,519,853,000	74.9
Michigan State University	1,319,735,000	1,988,166,000	66.4
University of Washington	2,512,516,000	3,970,537,000	63.3
University of Iowa	1,465,591,000	2,575,001,000	56.9
Indiana University	1,479,392,000	2,670,227,000	55.4
University of Minnesota	1,511,791,000	2,993,694,000	50.5
Ohio State University	2,210,887,000	4,636,450,000	47.7
University of California-Los Angeles	1,474,392,000	5,625,273,000	26.2
University of Wisconsin-Madison	541,859,000	2,351,452,000	23.0

TABLE 4**Financial Information for UW-Milwaukee and Selected Peer Institutions**

	<u>Total Available Net Assets</u>	<u>Total Expenses</u>	<u>Primary Reserve Ratio</u>
Temple University	\$1,525,400,000	\$2,292,842,000	66.5%
Rutgers*	1,136,834,000	1,802,440,000	63.1
Wayne State University*	371,956,000	839,987,000	44.3
University of Cincinnati	393,104,000	1,039,172,000	37.8
Cleveland State University	105,987,000	289,139,000	36.7
Georgia State University	132,894,000	593,195,000	22.4
University of Wisconsin-Milwaukee	85,319,000	509,504,000	16.7

* Information is for fiscal year 2011.

13. As shown in Table 2, the "primary reserve ratios" of public university systems vary widely. The UW System's "primary reserve ratio" of 25.3% is slightly below the median for the university systems shown of 28.8%. Tables 2 and 3 similarly show a wide variance in "primary reserve ratios" at large public universities; however, both UW-Milwaukee and UW-Madison have "primary reserve ratios" that are significantly less than those at the other institutions shown. However, the "primary reserve ratios" calculated for individual UW institutions may be somewhat misleading given the significant assets held UW System. For example, data provided by UW System officials shows that, of the \$414.1 million tuition appropriation balance for fiscal year 2012, \$127.5 million was held by UW System.

14. When comparing the financial statements of other universities and university systems, a number of additional factors should be considered. For example, some universities and university systems have the authority to issue bonds and therefore must keep additional reserves in order to secure debts and maintain favorable credit ratings. Examples of university systems that can issue debt include the University of Illinois, University of North Carolina System, the University of Missouri System, and the University of Texas System. By contrast, the state of Wisconsin issues debt on behalf of the UW System, which means that its debts are backed by the state's full faith and credit and that it is able to rely on the state's credit rating. In addition, some university systems operate benefits plans for their employees that may similarly require them to keep additional reserves. For example, the University of Colorado System provides post-retirement healthcare and life insurance benefits and a defined contribution retirement plan, the Pennsylvania State System of Higher Education provides a post-retirement defined benefits health care plan and tuition waivers for certain employees and their dependents, and the University of Texas System provides health insurance, dental insurance, life insurance, and other insurance programs for its employees. By contrast, all employee benefit programs for UW System employees are managed by the state Department of Employee Trust Funds.

15. In addition, the UW System's financial statements may not be reflective of all of the resources available to UW institutions. Most UW institutions have associated private foundations

that have been established for the benefit of the institution. Examples would include the University of Wisconsin Foundation, the Wisconsin Alumni Research Foundation, and the University of Wisconsin Medical Foundation, all of which were established in part to benefit UW-Madison. While there is no standard for calculating a university's or university system's "primary reserve ratio," NACUBO materials indicate that the assets and expenses of "component units," which would include foundations established for the benefit of an institution or system, should be considered. Because the UW System's financial report excludes financial information on these "component units," it may understate the UW System's true "primary reserve ratio."

16. UW System staff have indicated that the UW System President is working with Regent leadership to create a committee, consisting of Regents, chancellors, chief business officers, and others, to develop operating balance goals and reporting requirements. Allowing the Board of Regents to develop operating balance goals and reporting requirements may be appropriate given their status as the governing board of the UW System. However, given the importance of the public policy goal of maintaining a high quality system of higher education that is affordable for state residents, the Committee may determine that it is appropriate for the Legislature to have a role in establishing operating balance goals for the UW System and its institutions. One option may be to require the Board of Regents to submit proposed operating balance goals and reporting requirements to the Joint Committee on Finance for approval.

17. A second option would be to limit by law the amount of operating balances the Board of Regents could accumulate without the approval of the DOA Secretary and the Joint Finance Committee. This would be similar to the requirement under current law regarding the accumulation of auxiliary reserve funds.

18. The Legislature has limited the amount of auxiliary reserve funds UW institutions can accumulate since 1985. In that year, the Legislative Audit Bureau (LAB) found that many UW institutions had accumulated large cash reserves related to their auxiliary enterprises. Under 1985-87 biennial budget act, the Legislature used the \$22.6 million identified by the LAB as surplus reserve funds to partially offset tuition increases during the biennium and to support library acquisitions. The Legislature also prohibited the Board of Regents from accumulating auxiliary reserve funds without the approval of the DOA Secretary and the Joint Committee on Finance through passive review. Following the passage of the 1985-87 budget, the Board of Regents established reserve maxima for each institution and activity in consultation with LAB staff. These maxima were based on 2.5% of deferred maintenance costs, two years of debt service, two months of operating costs plus immediate needs and an allowance for planned major remodeling or new facilities. Under the 1997-99 biennial budget, the provision limiting the amount of auxiliary reserve funds was modified to require approval of the DOA Secretary and the Joint Committee on Finance only when a UW institution plans to accumulate auxiliary reserve funds in excess of 15% of the prior year's total revenues from auxiliary enterprises.

19. The 15% threshold adopted for auxiliary reserve funds may be higher than would be necessary for other PR appropriations including the tuition and extension student fees appropriations. First, the UW System's auxiliary enterprises are by definition self-supporting, meaning that they receive no state funding. Because state funding is provided for other activities,

such as instruction and academic support, a lesser amount of operating balances may be required for those activities. Second, revenues generated by auxiliary enterprises are used to repay program revenues supported borrowing issued by the state. This debt service represents a fixed cost that UW institutions are required to pay regardless of the level of revenues in any given year. As the state pays debt service related to bonds issued to build academic facilities, a lesser amount of tuition and extension student fees appropriation balances may be appropriate.

20. However, there is reason to believe that the current limit on auxiliary reserve funds may be too low. UW institutions are permitted to accumulate auxiliary reserve funds of greater than 15% of revenues if such action is approved by the DOA Secretary and the Joint Committee on Finance. In the most recent year, the UW System requested that nine of its 14 institutions be able to accumulate auxiliary reserves above that threshold. For all UW institutions combined, the planned auxiliary reserve balance for 2012-13 was \$103.7 million, equal to 21.7% of 2011-12 auxiliary revenues. While these balances may indicate that the current law limit on auxiliary reserve funds may be too low, they also demonstrate that such a limit can still provide a significant amount of flexibility to the institutions.

21. If the Committee chooses to limit the amount of PR appropriation balances that the Board of Regents can accumulate without the approval of the DOA Secretary and the Joint Committee on Finance, it may wish to limit tuition and extension student fees appropriation balances only, as these funds are most directly related to the public policy goal of maintaining a high quality system of higher education that is affordable for state residents. While the UW System has accumulated significant balances associated with other appropriations, these funds may be of lesser interest to the Legislature as they are not derived from student tuition and fees. The limit for the tuition and extension student fees appropriation balances may appropriately be expressed as a percentage of the amount budgeted for those revenues and the state GPR provided to the UW System, excluding debt service. These funds make up the UW System's "base budget" and provide primary support for the University's instructional, academic support, institutional support, and physical plant activities. As the UW System is prohibited from accumulating GPR appropriation balances, only tuition and extension student fees could be accumulated to create operating balances for these activities.

22. In 2011-12, the UW System's budget for tuition, extension student fees, and state GPR less debt service totaled \$2,112.1 million. Table 5 shows the amount of tuition and extension student fees the UW System would have been permitted to accumulate if the Legislature had limited the accumulation of such funds to various percentages of the UW System's "base budget" and the amount by which the UW System's tuition and extension student fees appropriation balances on June 30, 2012, exceeded those amounts.

TABLE 5

**Possible Limits on the UW System's Tuition and Extension Student Fee Balances
and the Amount by Which Current Balances Exceed Those Limits
(\$ in Millions)**

	<u>Limit*</u>	2011-12 Tuition and Extension Student Fees Appropriation <u>Balances Amount</u>	<u>Amount Above Limit</u>
10%	\$211.2	\$459.5	\$248.3
15%	316.8	459.5	142.7
20%	422.4	459.5	37.1

* Based on 2011-12 UW System combined tuition, extension student fees, and GPR budget less debt service of \$2,112.1 million

23. If the Committee elects to limit the amount of tuition and extension student fee revenue that the UW System may accumulate to an amount that is less than the current balances of these appropriations, a plan for the expenditure of the excess funds would have to be developed. Again, such a plan could be developed by the Board of Regents, the Legislature, or both.

24. A third option would be to direct the UW System, in consultation with the Legislative Audit Bureau (LAB), to develop an appropriate methodology to calculate the tuition and extension fees appropriation balances, and for other relevant appropriation balances. This option may be appropriate given the complexity of the issue and the difficulty in comparing the "primary reserve ratios" of public universities and university systems. It would also allow for the findings of an LAB audit currently being conducted related to this issue to be considered. The Committee could require the UW System to submit proposed appropriation balance limits for the UW System as a whole, and for individual UW institutions and related reporting requirements, to the Joint Committee on Finance for approval by March 1, 2014.

25. In the case of a tuition freeze, the Board of Regents could draw down the tuition appropriation balance to fund costs included in the biennial budget that generally would have been funded in part with revenues generated by tuition increases. These costs include standard budget adjustments, increases in fringe benefit costs and employee salaries, and energy costs. Based on information provided by the UW System and DOA, it is estimated that the Board of Regents would have had to increase tuition by an amount sufficient to generate \$21.8 million in 2013-14 and \$30.9 million in 2014-15 to fund these costs. The estimated tuition cost associated with each item is shown in Table 6. Based on these estimates, imposing a tuition freeze in both years of the biennium could reduce the amount of the tuition appropriation balance by a total of \$52.7 million. It should be noted that, in the case of a tuition freeze for resident undergraduates, some portion of these costs may be funded with additional tuition revenue generated by tuition increases for nonresident, graduate, and professional students or increases in enrollment, instead of funds from the tuition appropriation balance.

TABLE 6

**Estimated Tuition Costs Associated with GPR Funding
Changes Included in the Governor's Budget
(\$ in Millions)**

	Tuition Cost	
	<u>2013-14</u>	<u>2014-15</u>
Standard Budget Adjustments	\$3.9	\$3.9
Compensation Plans	15.3	23.9
Fuel and Utilities	<u>2.5</u>	<u>3.1</u>
Total	\$21.7	\$30.9

ALTERNATIVES

A. Oversight Relating to PR Balance

1. Require the Board of Regents to submit proposed PR appropriation balance goals and reporting requirements to the Joint Committee on Finance for approval.

2. Limit the amount of balances the Board of Regents may accumulate from tuition and extension student fees without the approval of the DOA Secretary and the Joint Committee on Finance, under a 14-day passive review process, to the following percentage of the UW System's combined GPR, tuition, and extension student fees budget less debt service in the same fiscal year. Require the Board of Regents to report both the gross amount of accumulated tuition and extension student fees and total PR appropriation balances annually by September 15.

- a. 10%
- b. 15%
- c. 20%

3. Direct the UW System, in consultation with the Legislative Audit Bureau, to develop an appropriate methodology to calculate the tuition and extension fees appropriation balances, and for other relevant appropriation balances. Require the UW System to submit proposed appropriation balance limits for the UW System as a whole, and for individual UW institutions and related reporting requirements, to the Joint Committee on Finance for approval by March 1, 2014, under a 14-day passive review process

4. Take no action. Under this alternative, the Board of Regents would determine the appropriate level of UW System PR appropriation balances and reporting requirements.

B. Tuition

1. Specify that undergraduate, resident tuition in 2013-14 and 2014-15 cannot exceed

the amount charged at each institution in 2012-13.

2. Take no action. Under this alternative, the Board of Regents would determine tuition levels.

Prepared by: Emily Pope