July 12, 1996

TO:    Members of the Board of Trustees

FROM:  Mark A. Emmert
        Wilbur R. Jones

SUBJECT: POLICY ON FINANCIAL RESERVES (REVISED)

RECOMMENDATION:

That the Board of Trustees approve the enclosed, revised policy on maintaining financial reserves for the University of Connecticut (excluding the Health Center).

BACKGROUND:

The revised policy sets parameters for a reasonable level of reserves to address unforeseen circumstances and establishes other approved purposes and amounts for which dedicated reserves may be designated. Attachments include the background and rationale for the development of this revised policy, a copy of the current reserve policy approved in January 1993, comparisons of the University's reserve level to other public universities, and a comparison of reserve levels in the four-year budget balancing plan to levels that would results from strict adherence to the recommended policy.

Attachments
University of Connecticut
Policy on Financial Reserves (Revised)

Definition of Terms:

- **Fund Balance** is an accounting term used to describe the difference between a non-profit entity's assets and liabilities.

- **Reserves** are portions of the fund balance that are set aside for specific purposes.

- **Restricted Reserves** are funds that are restricted as to expenditure purpose by virtue of specific agreements between the University and the funds' providers.

- **Unrestricted Reserves** are funds over which the Board has discretionary authority.

- **Unrestricted Designated Reserves** are tied to specified purposes designated by the University such as program start-up costs, program expansion, capital projects, and other major one-time projects.

- **Unrestricted Undesignated Reserves (Contingency Reserves)** are not dedicated to a specific purpose but are available to address unforeseen circumstances such as appropriation reductions, unexpected energy price increases, and costs related to extreme weather conditions.

- The **Available Funds Ratio** is a widely-used indicator of the appropriateness of fund balances. This ratio is computed by dividing the unrestricted fund balance by annual unrestricted current fund expenditures plus mandatory transfers. To convert this ratio into an easy-to-understand value, it must be multiplied by 12. That calculation provides the number of months of operations the fund balance could provide without any additional revenue. In effect, this indicates how long the institution could operate if, for some reason, all sources of revenue were cut off and the institution was forced to operate on its financial reserves.

Policy:

- The University of Connecticut will endeavor to maintain unrestricted available funds in an amount equal to 25 percent or 3 months of its annual unrestricted current fund expenditure budget. The target level for the contingency (undesignated) reserve component of this fund balance will be 2 months, that may vary as designated reserves increase or decrease in amount. These levels are commensurate with good business practices and are consistent with industry standards.

- Generally, unrestricted funds should be budgeted for expenditure in the year they are generated. Exceptions to this rule should be supported by specific program or spending plans, legal obligations, or relationship to succeeding fee or sales rates.
The Vice Presidents and the Director of Athletics will recommend and justify to the Chancellor and President annually the level of designated reserves that exist and they deem prudent and necessary to the management of enterprise or auxiliary accounts and programs in their respective areas. Such reserves shall be justified as to amount and specific purpose and will be approved as a component of the budgeting process.

The total University-wide unrestricted reserves and individual program reserves should be evaluated annually to ensure that the sum of individual program reserves are compatible with the institution's reserve policy, immediate spending needs and priorities.

Reserves designated for capital projects should be accounted for and reported as "unexpended plant funds".

Reserves designated for debt service commitment should be deposited in the State Treasurer's accounts.

The President shall recommend to the Board of Trustees, annually the level of all reserves including those to be held in accounts and programs under the jurisdiction of the Vice Presidents and the Director of Athletics.
Attachment A

Background and Rationale

Relationship to Current Policy:

The revised policy builds upon the current policy approved by the Board of Trustees in January 1993. When the current policy was approved, a recommendation was made that the Board of Trustees review this policy no later than January 1996 to assess the need for revision. The survey of other University's policies presented at the March Board of Trustees meeting represented a first step in the process of reviewing the existing policy to assess the need for revision. Results of this survey indicated little or no reserve policy activity elsewhere.

The purpose of the existing policy (included as Attachment B) is to establish guidelines for determining how much of the University's financial resources will be budgeted for annual expenditure during a given annual operating cycle versus being carried over across fiscal year boundaries for future expenditure. The policy requires that specific amounts budgeted for carry over will be reviewed annually as are the revenue and expenditure components of the operating budget.

The reserve policy applies to all funds which the Board of Trustees is statutorily responsible to administer. Since some funds are restricted as to expenditure purpose by virtue of specific agreements between the University and the funds' providers, this policy does not apply to such funds. The Board does have discretionary authority over all unrestricted funds, however, and therefore, this policy applies to all unrestricted funds in the University of Connecticut operating fund.

Significant Revisions:

This policy promotes effective use of financial resources consistent with institutional priorities, provides incentives for self-help initiatives, and establishes policy guidance for internal and external financial reporting.

The revised policy incorporates the existing policy and adds to it by requiring that unrestricted designated reserves be specifically identified as to purpose and amount, calls for reserves designated for capital projects to be accounted for separately from operating reserves, calls for reserves designated for debt service commitment to be deposited in the State Treasurer's accounts, and sets parameters for prudent levels of reserves.

The revised policy notes the distinction between designated and contingency (undesignated) reserves. Designated reserves are tied to specific purposes. Examples of these types of accounts are reserves for program expansion, major one-time projects, debt-service and program start-up costs. Contingency reserves are not dedicated to any specific purpose. They are maintained to address budget requirements associated with unforeseen circumstances such as unexpected energy
price increases, unanticipated loss of revenue due to enrollment declines, allotment or appropriation reductions, collective bargaining increases, and costs related to natural disasters such as extreme weather, for example. It should be noted that in the absence of any contingency reserves, the Board has the authority to reassign designated reserves for contingency purposes.

Primary Purposes of The Policy:

Detailed information on the purposes and fund levels of unrestricted reserve accounts will enhance fund management. Also, the perception that the University possesses numerous pools of discretionary and non-discretionary money that are not put to good use will be allayed. Greater attention to the level of contingency reserves also will ensure that existing programs will not suffer unnecessarily when funds are available to address their needs during fiscal crises.

The reasons for careful attention to reserves are numerous. They were outlined effectively in the Texas Higher Education Coordinating Board study cited in the March report to the Board regarding our survey of University reserve policies. Institutions of higher education differ from other state agencies in several ways. They typically have more and different sources of revenue than other agencies, the legislature has given them more flexibility in the ways that they manage their financial resources, and they provide many services for which no state support is given.

Some people outside of higher education believe that institutions should be required to use unrestricted fund balances as an alternative to state appropriations. The higher education community has generally contended that fund balances are consistent with good business practice and that either reducing the balances or using the interest on the balances would seriously damage their operations.

One cannot by looking at fund balances alone, determine if specific fund balances are “too large” or “too small.” Small institutions, with lower operational costs, fewer auxiliary enterprises, and other demands for resources can operate effectively with much smaller fund balances than larger, more complex institutions.

In addition, it has long been customary for the rating agencies and the bond market to require bond issues be supported by reserve funds equal to the average annual debt service. Institutions that pay debt service from institutional fund balances require a higher ratio than institutions that only must meet operating costs.

Criteria for Establishing Reserve Levels:

One widely-used indicator of the appropriateness of fund balances is the “available funds ratio”. This ratio is computed by dividing the unrestricted fund balance by annual unrestricted current fund expenditures plus mandatory transfers. To convert this ratio into an easy-to-understand value, it must be multiplied by 12. That calculation provides the number of months of operations the fund balance could provide without any additional revenue. In effect, this indicates how long
the institution could operate if, for some reason, all sources of revenue were cut off and the institution was forced to operate on its financial reserves.

There is no firmly established number of months which, by definition, is too high or too low. Several sources, however, including the KPMG-Peat Marwick public accounting firm and the National Association of College and University Business Officers, indicate that an institution that has not run consistent deficits and maintains a value of between 2.4 and 6 months should be considered in good financial condition.

Attachment C summarizes available funds ratios for the University of Connecticut and ten other universities. The University of Connecticut ranked 8th among the 11 institutions in FY 1994-95 with 2.0 months of available funds. Six of the eleven institutions met the industry guidelines of 2.4 to 6 months.

The revised policy sets a target of a 3 month available funds ratio for the University of Connecticut which falls within the industry standards presented above. In addition, a target of 2 months is set for the contingency reserve component of available funds. If the designated portion of available funds declines to the point that total unrestricted available funds falls below 3 months, then contingency reserves should be increased accordingly.

Another stipulation in the revised policy is that recommendations and justifications should be made to the Chancellor, who is the Chief Operating Officer of the institution as well as the President. The current policy, which predates the recent reorganization has recommendations and justifications being made to the President.
Attachment B

Existing Policy

The Vice Presidents and the Director of Athletics will recommend and justify to the President annually the level of reserve they deem prudent and necessary to the management of accounts and programs in their areas. In arriving at the stipulation of any reserves, the following criteria will be employed:

1. Generally, unrestricted funds should be budgeted for expenditure in the year they are generated. Exceptions to this rule should be supported by specific program or spending plans, legal obligations, or relationship to succeeding fee or sales rates.

2. The total University-wide unrestricted reserves should be evaluated annually to ensure that the sum of individual program reserves are compatible with the institution’s immediate spending needs and priorities.

The President shall recommend to the Budget and Finance Committee of the Board of Trustees, the level of any reserves that should be held in accounts and programs under the jurisdiction of the Vice Presidents and the Director of Athletics.
**Attachment C**
Available Funds Ratios for Selected Universities
FY 1994-95

<table>
<thead>
<tr>
<th>Available Funds Ratio (months)</th>
<th>Unrestricted Fund Balance</th>
<th>Unrestricted Current Funds Expenditures and Mandatory Transfers</th>
</tr>
</thead>
<tbody>
<tr>
<td>University of Virginia</td>
<td>6.9</td>
<td>$400,205,000</td>
</tr>
<tr>
<td>University of Pittsburgh</td>
<td>4.5</td>
<td>194,959,000</td>
</tr>
<tr>
<td>Rutgers University</td>
<td>3.6</td>
<td>191,268,000</td>
</tr>
<tr>
<td>Ohio State University</td>
<td>3.3</td>
<td>305,863,000</td>
</tr>
<tr>
<td>University of Iowa</td>
<td>2.9</td>
<td>233,624,402</td>
</tr>
<tr>
<td>Indiana University</td>
<td>2.7</td>
<td>167,064,271</td>
</tr>
<tr>
<td>University of Maine</td>
<td>2.2</td>
<td>49,489,331</td>
</tr>
<tr>
<td>University of Connecticut</td>
<td>2.0</td>
<td>53,516,034</td>
</tr>
<tr>
<td>University of New Hampshire</td>
<td>1.6</td>
<td>29,183,000</td>
</tr>
<tr>
<td>University of Massachusetts</td>
<td>1.4</td>
<td>43,317,000</td>
</tr>
<tr>
<td>University of Rhode Island</td>
<td>0.3</td>
<td>3,527,460</td>
</tr>
</tbody>
</table>


## Attachment D
### Available Funds Ratio
#### Comparison of Policy to 4-Year Plan

<table>
<thead>
<tr>
<th></th>
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<th></th>
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</thead>
<tbody>
<tr>
<td><strong>Unrestricted Funds - Balance</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Policy</td>
<td>90,586,418</td>
<td>93,719,196</td>
<td>95,993,370</td>
<td>98,000,600</td>
<td>99,998,044</td>
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<tr>
<td>Expenditures</td>
<td>362,345,673</td>
<td>374,876,783</td>
<td>383,973,478</td>
<td>392,002,400</td>
<td>399,992,174</td>
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<tr>
<td><strong>Policy Funds Ratio</strong></td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
<td>25%</td>
</tr>
<tr>
<td>Months</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td><strong>Budget Balancing Plan Ratio</strong></td>
<td>15%</td>
<td>10%</td>
<td>8%</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>Months</td>
<td>1.8</td>
<td>1.3</td>
<td>1.0</td>
<td>0.8</td>
<td>0.8</td>
</tr>
</tbody>
</table>
On a motion by Mrs. Berry, seconded by Mr. Treibick, THE BOARD VOTED to approve a multi-year Budget Balancing Plan (Fiscal Years 1997-99), designed to bring the University's Unrestricted Operating Budget in balance by June 30, 1999. Background information listed as agenda Attachment T is attached to the file copy of the Board minutes.

2. On a motion by Mrs. Berry, seconded by Mr. Napolitano, THE BOARD VOTED to approve a $383,973,478 FY 1996-97 Unrestricted Operating Budget (expenditures and mandatory transfers of $382,498,478; non-mandatory transfers of $1,475,000) including State support of $194,134,016 and net Tuition and Fees revenue of $104,273,236. Background information listed as agenda Attachment U is attached to the file copy of the Board minutes.

3. Chairwoman Berry reminded the Board that the Policy on Financial Reserves was a goal not limited in terms of how reserves are used since there are occasions when reserves must be used to address the issue of a balanced budget. On a motion by Mrs. Berry, seconded by Ms. Bailey, THE BOARD VOTED to approve the Revised Policy on Maintaining Financial Reserves for the University of Connecticut (excluding the Health Center). Background information listed as Attachment V is attached to the file copy of the Board minutes.

4. Chairwoman Berry called upon Provost Emmert who introduced Dean Ross MacKinnon from the College of Liberal Arts and Sciences who commented on Option B in the Capital Budget Plan for UConn 2000. Dean MacKinnon also called upon Dr. Richard Cooper, Director of the Marine Science Program at Avery Point, to answer questions about Option B and to clarify the relationship between the Marine Science Technology Center and the Department of Marine Sciences.

On a motion by Mrs. Berry, seconded by Mr. Treibick, THE BOARD VOTED to approve the 1996-97 Capital Budget (with Option B). Background information listed as agenda Attachment W is attached to the file copy of the Board minutes.

5. On a motion by Mrs. Berry, seconded by Mr. Abromaitis, THE BOARD VOTED to approve the Second Supplemental Indenture Authorizing University of Connecticut General Obligation Bonds, 1996 series B. Background information listed as agenda Attachment XYZ is attached to the file copy of the Board minutes.

6. On a motion by Mrs. Berry, seconded by Mr. Treibick, THE BOARD VOTED to approve the State Appropriation Operating Budget Request for the Biennium 1997-1999 and FY 1997-98 Tuition Rates and the State
MINUTES OF THE MEETING
OF THE BOARD OF TRUSTEES

THE UNIVERSITY OF CONNECTICUT

Held at the University of Connecticut at Avery Point
Branford House, Avery Point, Groton, Connecticut

July 12, 1996

The meeting was called to order at 1:20 p.m. by Vice-Chairman Berkley. Trustees present were: Mmes. Bailey, Berry, Ferris, and Leonardi; Messrs. Abromaitis, Bellafiore, Berkley, Cicchetti, Heist, Napolitano, Saslow, Stewart, and Treibick. Governor Rowland was represented by Mr. David O’Leary. Trustees who participated by phone were: Ms. Smith and Messrs. Downey and Jacobs.

Trustees absent were: Messrs. Jacobs and Sergi.

University staff present were: President Hartley, Chancellor and Provost for University Affairs Emmert, Chancellor and Provost for Health Affairs Cutler, Vice Presidents Wiggins, Allenby, and Jones, Attorney Shapiro, and Mr. McFadden.

All actions taken were by unanimous vote of the Trustees present, except as otherwise noted.

Several members of the public addressed the Board regarding the Marine Sciences & Technology Center and the Department of Marine Sciences at the Avery Point Campus. They were: Senators Cathy Cook and Melodie Peters, and Representatives Robert Simmons, Lenny Winkler, Andrea Stillman, and Nancy DeMarinus.

Other members of the public addressed the Board regarding the closure of the Printing Services Department. They were: Jennifer Shaw, Beverly Bessette, Lori Nye, David Estell, and Steven Perruccio.

On a motion by Mr. Treibick, seconded by Mr. Napolitano, THE BOARD VOTED to go into Executive Session at 1:20 p.m. for the purpose of discussing matters of personnel, pending litigation, and collective bargaining. The Chairman noted that on the advice of counsel only the staff members whose presence was necessary to provide their opinion would be permitted to attend Executive Session.

All members of the Board noted above were present at this time.

1. Personnel matters were discussed. Executive Secretary Peter McFadden, Richard Bachoo, and Irene Conlon were present for this discussion.

There being no further business proper to Executive Session, the Board reconvened in Open Session at 3:30 p.m.

Chairman Roney welcomed new Student Trustee Michael Bellafiore to his first meeting of the Board.