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TOPICS OF LEGISLATIVE INTEREST

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Michigan Public Universities' Unrestricted Net Assets By Bill Bowerman, Associate Director

Introduction

According to a January 16, 2012, article in the *Detroit Free Press* entitled "Michigan's public universities see 24% increase in 'unrestricted' net assets", unrestricted net assets at public universities increased from \$3.4 billion to \$4.2 billion over the previous fiscal year. The article juxtaposed the growth in unrestricted net assets, tuition increases, and employee concessions, suggesting that unrestricted net assets should have been used to mitigate the need for tuition increases and employee concessions. The following information provides an overview of unrestricted net assets and how those funds are currently programmed by each university.

Unrestricted Net Assets

Net assets are basically the difference between assets and liabilities. The Governmental Accounting Standards Board (GASB) states that net assets are represented in three components:

1. Invested in Capital Assets, Net of Related Debt. This component is the difference between the amount shown for capital assets and the outstanding debt incurred to finance the capital assets.
2. Restricted Net Assets. This component includes resources that are controlled by the provider of the resource. For universities, this category would include gifts for specific purposes, e.g. building an art museum, or an endowment fund created for a specific purpose.
3. Unrestricted Net Assets. Unrestricted net assets are all resources not included in the other components. These assets can be used for any purpose, and were the focus of the *Detroit Free Press* article. Unrestricted net assets are not restricted by the source of the funds, but in many cases they are already programmed for specific purposes by the institution. Therefore, the term "unrestricted" can be misleading. Also, it is possible for unrestricted net assets to be represented as a negative amount. This does not necessarily mean that the university is in a current negative cash situation. The negative amount can relate to costs that will be paid in future years and previously accounted for on a pay-as-you-go basis. (Western Michigan University's unrestricted net assets are an example of this scenario, as described below.)

Background

Table 1 compares fiscal year (FY) 2010-11 amounts listed as unrestricted net assets to FY 2010-11 current fund revenue, as reported in the Higher Education Information Data Inventory (HEIDI). Current fund revenue is defined in HEIDI as prior fiscal year revenue recorded in the General Fund, expendable restricted fund, designated fund, and auxiliary fund as defined in the Manual for Uniform Financial Reporting. This includes auxiliary operations, such as hospitals and dormitories, and operations funded from restricted revenue sources (e.g. federally funded research). The unrestricted net assets ranged from a negative 9.6% to 56.1% of current fund revenue. While a negative 9.6% ratio would appear to represent a bleak current financial situation and the 56.1 positive ratio might appear to indicate that a university was hoarding funds, the amounts programmed by each university need to be taken in context. For example, Western Michigan University has listed negative unrestricted net assets in FY 2009-10 and FY 2010-11 of \$68.5 million and \$56.2 million, respectively. The negative amount is due to the fact that universities implemented GASB Statement No. 45 Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions (OPEBs) beginning with the fiscal year that ended June 30, 2008. Before that time, the obligations related to future payments to retired employees were accounted for on a pay-as-you-go basis. While they are now accounted for in

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the year the liability is incurred, the actual payments will be made in future years. Large positive unrestricted balances can be equally misleading. While unrestricted net assets can theoretically be used for anything, the funds in many cases are programmed for the costs of long-term facility maintenance (such as facility repairs, boilers, and roofs). The funds also could be earmarked for future capital outlay projects.

Table 1

Public University Unrestricted Net Assets as a Percent of Current Fund Revenue			
	Unrestricted Net Assets	Current Fund Revenue	Percent of Current Fund Revenue
Universities			
Central.....	\$276,100,000	\$492,549,271	56.1%
Eastern.....	40,500,000	385,260,957	10.5
Ferris.....	111,400,000	279,330,783	39.9
Grand Valley.....	166,169,000	445,804,119	37.3
Lake Superior.....	4,055,185	55,724,287	7.3
Michigan State.....	789,000,000	2,051,281,109	38.5
Michigan Tech.....	9,606,105	249,161,260	3.9
Northern.....	92,051,086	189,514,015	48.6
Oakland.....	145,793,000	301,490,015	48.4
Saginaw Valley.....	37,773,000	155,233,702	24.3
UM-Ann Arbor ¹⁾	704,295,293	2,956,666,105	23.8
UM-Health System ¹⁾	1,839,396,473	2,478,534,443	74.2
UM-Dearborn ¹⁾	22,841,362	118,802,367	19.2
UM-Flint ¹⁾	36,560,019	108,389,344	33.7
Wayne State.....	220,000,000	923,564,541	23.8
Western.....	(56,200,000)	585,393,845	(9.6)
Total.....	\$4,439,340,523	\$11,776,700,163	37.7%
¹⁾ University of Michigan did not reconcile amounts with information submitted to HEIDI. The University of Michigan states that differences between current fund revenue in audited financial statements and HEIDI are mainly attributable to tuition discounts and inter-university billings.			

Source: HEIDI and University Financial Offices

The balance of this article includes information provided by each university regarding amounts reported as unrestricted net assets at the close of FY 2010-11. The allocations listed demonstrate that while unrestricted net assets are not constrained by the source of the funds, in many cases they are already allocated to planned future expenditures. Each institution stated the necessity of having funds available for long-term planning needs, including maintenance of infrastructure and emergency situations. A positive unrestricted net asset amount at the end of the fiscal year has an impact on an institution's bond rating, thereby reducing long-term borrowing costs. Universities also stated that most unrestricted net assets are accumulated over time and it would not be prudent to use these funds for annual ongoing expenses.



Amounts Reported as Unrestricted Net Assets

Central Michigan University. Central Michigan University stated that unrestricted net assets serve to provide adequate cash flow for operations, support strong financial ratios to enable access to low interest rates on debt, provide funding for scholarships, support necessary reserves for self-funded health benefit and other insurance programs, and fund deferred maintenance and other capital projects. Approximately 35.0% of FY 2010-11 unrestricted net assets were allocated to deferred maintenance and other capital projects such as the addition to The Health Professions Building, the renovation of The Bovee University Center Building, and Anspach Hall (the largest campus classroom building) and other future projects.

Central Michigan University FY 2010-11 Unrestricted Net Assets	
Allocation	Amount (in Millions)
Capital Projects.....	\$96.5
Debt Stabilization and Insurance Reserves	34.3
Unrealized Gain/(Loss).....	17.7
Contractual Commitments	21.6
Department and Auxiliary Capital Balances	73.4
Funds that Function as Endowments	32.6
Total	\$276.1

Eastern Michigan University. The university stated that the primary purpose of its unrestricted net assets is to ensure a steady cash flow, ensure a low interest rate for borrowing, and serve as the institution's emergency reserves. As shown in Table 1, the FY 2010-11 unrestricted net assets amount was 10.5% of current fund revenue of the university. This amount would fund operating expenses of the university for approximately 43 days. Eastern used \$10.0 million of its unrestricted net assets in FY 2010-11 for its share of the cost to renovate a large classroom building (Pray-Harrold).

Eastern Michigan University FY 2010-11 Unrestricted Net Assets	
Allocation	Amount (in Millions)
General Fund.....	\$18.5
Designated Fund.....	7.1
Auxiliary Fund	6.5
Plant Fund.....	8.4
Total	\$40.5

Ferris State University. Ferris stated that the largest portion of its unrestricted net asset balance is designated for operational and instruction needs including instructional equipment, scholarships, maintenance of physical plant, university-wide plant projects ranging from a new student center to pedestrian safety projects, professional development of faculty and staff, the institution's self-insurance program, auxiliary operations support, student loan fund balances, and paper assets such as booked but unrealized investment gains. The following allocations were provided regarding the FY 2010-11 unrestricted net assets totaling \$111.4 million.

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Ferris State University FY 2010-11 Unrestricted Net Assets	
Allocation	Amount (in Millions)
Departmental Operating Support	\$36.3
Plant Maintenance	34.6
Plant Projects in Progress	24.6
Auxiliary Operations.....	1.2
Student Loan Funds	1.0
Unrealized Gains	6.2
Self Insurance.....	1.0
Other	6.5
Total	\$111.4

Grand Valley State University. Grand Valley stated that its unrestricted net assets reflect operating cash flow, construction of academic facilities, reserves for the campus housing system (funded as an auxiliary enterprise), and funds for new and additional academic programs. Most of the unrestricted net assets are committed to one-time uses, not annual operating costs. Grand Valley State University has two large construction projects under way, the Mary Idema Pew Library and the L. William Seidman Center for the College of Business. The two projects total \$100.0 million and are not being constructed with State capital outlay funds.

Grand Valley State University FY 2010-11 Unrestricted Net Assets	
Allocation	Amount (in Millions)
Endowment.....	\$8.1
Capital Projects in Process.....	36.5
Housing and Auxiliary Repair & Maintenance.....	15.0
Debt Service	6.7
Academic Initiatives and Technology	22.5
Future Capital Projects and Debt Service	57.6
Reserves for Operations and Cash Flow	19.3
Uncommitted Funds.....	0.5
Total	\$166.2

Lake Superior State University. The university reported a General Fund deficit of \$532,067. The \$1.1 million in designated funds is a combination of approximately 55 funds, including small gifts designated for a specific purpose and charter school funds. The auxiliary funds include an athletic fund deficit and small fund balances for housing, food services, and the health care center, as well as \$285,000 in a parking fund designated to repair/replace parking lots and \$107,000 for fleet vehicle replacement. The insurance reserves include approximately \$700,000 to cover insurance deductibles, an additional \$500,000 in workers' compensation reserves, and a health insurance reserve equal to about four months' premium. The university's average bank balance is about four to five months' operating cash flow.

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Lake Superior State University FY 2010-11 Unrestricted Net Assets	
Allocation	Amount (in Millions)
General Fund Deficit.....	\$(0.5)
Designated Funds.....	1.1
Auxiliary Funds	0.4
Insurance Reserves.....	3.1
Total	\$4.1

Michigan State University. The university's unrestricted net assets are designated for academic, research, and outreach programs and initiatives, postemployment benefits, and capital asset renewals and replacements.

FY 2010-11 Unrestricted Net Assets	
Allocation	Amount (in Millions)
Capital and Infrastructure	\$295.0
Programmatic Commitments	270.0
Departmental Working Capital	213.0
Quasi-Endowments	81.0
Retirement and Insurance	(80.0)
Uncommitted Funds.....	10.0
Total	\$789.0

Michigan Technological University. The university allocated over \$5.4 million of the unrestricted net assets to fund the Michigan Public School Employees' Retirement System (MPERS) program. The two largest parts of the payment are for retiree health care benefits, which the university no longer subsidizes for 90.0% of its current employees, and an assessment on university employees to account for the MPERS unfunded liability. The balance of unrestricted net assets was allocated for student financial aid.

FY 2010-11 Unrestricted Net Assets	
Allocation	Amount (in Millions)
MPERS.....	\$5.4
Student Financial Aid.....	4.2
Total:	\$9.6

Northern Michigan University. The \$92.1 million in unrestricted net assets reflects amounts identified for capital projects, long-term maintenance projects, reserves for student loans, departmental activities and cash flows, contractual commitments, funds functioning as endowments, debt stabilization reserves, self-insurance reserves for health, property, and liability, and reserves for auxiliary activities.

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FY 2010-11 Unrestricted Net Assets	
Allocation	Amount (in Millions)
Capital and Long-Term Maintenance Projects.....	\$32.8
Reserves for Student Loans, Departmental Activities, and Cash Flow	19.9
Contractual Commitments (encumbrances at year-end)	13.1
Funds Functioning as Endowments	11.3
Debt Stabilization Reserves	7.1
Self-Insurance Reserves	4.0
Reserves for Auxiliary Activities	3.9
Total	\$92.1

Oakland University. Oakland University stated that the reserves are funded based on generally accepted accounting principles (GAAP) and endorsed/expected by external auditors, rating agencies, bond buyers, and donors. Unrestricted net assets are programmed for capital projects, OPEB, debt service, maintenance, insurance, and other functions.

Oakland University FY 2010-11 Unrestricted Net Assets	
Allocation	Amount (in Millions)
Capital Projects in Process	\$12.1
Debt Service Reserve	7.8
Postemployment Benefit Costs.....	10.6
Quasi-Endowments (scholarships, teaching, research, library support)	16.3
Encumbrances/Carry Forwards	9.1
Maintenance Reserves	17.1
Parking Reserves.....	4.3
Auxiliary Operations Fund (housing, student center, theatre, etc.)	8.3
Rainy Day Fund.....	4.0
Reserves for Insurance, Workers'/Unemployment Compensation, Unrealized Investment Gain/Loss	23.1
Gift Funds, Indirect Cost Recovery, Other Activities	33.1
Total	\$145.8

Saginaw Valley State University. Most of the university's \$37.7 million unrestricted net assets were designated for capital projects and deferred maintenance. Approximately \$1.8 million (4.8%) was undesignated and available as a contingency for enrollment/revenue declines or other unforeseen circumstances having a negative impact on operating budgets.

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FY 2010-11 Unrestricted Net Assets	
Allocation	Amount (in Millions)
Capital Projects and Repair Services.....	23.4
Auxiliary Operations.....	1.4
Designated for Department Use.....	11.1
Amounts Obligated by Contractual Commitments	0.1
Undesignated.....	1.8
Total	\$37.8

University of Michigan. Unrestricted net assets for the University of Michigan totaled \$2.6 billion. This amount includes the University of Michigan Ann Arbor, Dearborn, Flint, and the University of Michigan Health System (hospital). Of that amount, \$1.8 billion (70.0%) is attributable to the University of Michigan Health System.

Nonhealth system unrestricted net assets are earmarked by the university for building projects and plant maintenance and equipment reserves, self-insurance (medical professional liability, property damage, general liability and educators' legal liability, workers' compensation, and auto liability), employee benefits, and other academic and operational support. The following table lists the unrestricted net assets for University of Michigan educational institutions (Ann Arbor, Dearborn, and Flint). Unrestricted net assets for nonhealth system operations equaled 24.0% of nonhealth system current fund revenue.

University of Michigan Nonhealth System FY 2010-11 Unrestricted Net Assets	
Allocation	Amount (in Millions)
Building Projects & Plant Maintenance and Equipment Reserves	\$361.8
Self-Insurance (Veritas).....	65.4
Employee Benefits.....	25.3
Other, Primary Academic and Operational Support.....	311.2
Total	\$763.7

University of Michigan Health System unrestricted net assets totaled \$1.8 billion and on a comparative basis, equaled 74.2% of health system current fund revenue for FY 2010-11. The unrestricted net assets are generated by patient fees and accumulated by the University of Michigan Health System for costs related to long-range planning to expand and continually improve facilities, implementation and certified electronic medical records as required by the Federal government, and implementation of health care reforms.

Wayne State University. For FY 2010-11, Wayne State University's unrestricted net assets totaled \$220.0 million. This was a reduction from \$235.1 million in the previous fiscal year. Over 71.2% of the university's allocations of the unrestricted net assets related to plant investment funds, designated fund activities, and faculty and research initiatives.

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Wayne State University FY 2010-11 Unrestricted Net Assets	
Allocation	Amount (in Millions)
Prior Year Encumbrances	\$13.3
Faculty and Research Initiatives	64.0
Financial Aid	1.2
Academic Support	9.3
Division/Central Account	14.2
Strategic Initiatives.....	19.7
Designated Fund Activities	43.8
Plant Investment Funds.....	48.8
Miscellaneous	5.7
Total	\$220.0

Western Michigan University. Western's unrestricted net assets have a negative balance as a result of the university's "Other Postemployment Retirement Benefits" (OPEB) liability. The university provides life insurance, health, and dental benefits, including prescription drug coverage, to retired employees, their spouses, and dependent children. As of June 30, 2011, the OPEB liability amounted to \$149.0 million. The university is working toward reducing the OPEB liability. Unrestricted net assets would be a positive \$93.0 million if the university excluded the OPEB liability.

Western Michigan University FY 2010-11 Unrestricted Net Assets	
Allocation	Amount (in Millions)
Debt Service	\$25.8
Construction Commitments	7.4
Auxiliary Operations Fund Balance	8.2
Student Support.....	1.0
WMU Share of Employee Insurance and Benefits.....	7.0
Maintenance and Infrastructure Reserves	27.3
Reserves to Improve and Maintain Parking Facilities	4.0
Research and Academic Program Needs	12.3
OPEB Liability	(149.2)
Total	(\$56.2)

Conclusion

The variance in unrestricted net assets from year to year is affected by the timing of capital projects, how institutions account for future unfunded liabilities, and interest earnings on funds. While unrestricted net assets are not designated for a specific purpose by the source of the funds, they are in most cases already programmed by the universities for specific purposes, including emergency needs, deferred maintenance, safety upgrades, capital improvements, insurance reserves, academic and research initiatives, and financial stability (cash flow).

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State funding reductions also have affected the need for institutions to save for capital maintenance costs. Before State budget shortfalls began in 2001, the State assisted universities with capital maintenance costs. The last appropriation specifically for this purpose was Public Act 291 of 2000, which included \$45.0 million for infrastructure, technology, equipment, and maintenance at Michigan public universities. Costs of maintaining infrastructure are significant. The FY 2010-11 Michigan Higher Education Institutional Data Inventory lists current fund total building square footage at approximately 117.9 million square feet. Over time, costs of maintaining those facilities include the replacement of roofs, mechanical systems, electrical, plumbing, safety upgrades, and other building improvement costs.

Unrestricted net assets accumulate over years and are not part of an ongoing source of funds; therefore, universities maintain that the funding should not be used for recurring operational costs. Using these funds to cover ongoing operational costs or to temporarily reduce tuition would result in budget issues in future years. While there is no general rule or standard regarding what is the most appropriate amount of funding for unrestricted net assets, maintaining a sufficient balance is prudent to cover operational costs over a period of time, possible emergency situations, and facility repair and upgrades related to the delivery of education.