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News

So You Say You're Broke?

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Hearing that the University of California system had $2.5 billion in "unrestricted net assets" on hand in 2010 could make anyone question the necessity of the 32 percent tuition hike that has been proposed, or the 11 to 26 furlough days that more than 100,000 employees were forced to take in 2009.

Similar scenarios have played out in two other states in the last month, as different groups suggested that state universities were, in their view, hoarding funds while simultaneously demanding more money from students, denying pay increases to faculty and staff members, and fighting against cuts in state funding. In Michigan it was a **faculty union in the middle of contract negotiations**. In Ohio it was the **state senate's finance committee chairman**.

The problem with the claim, administrators say, is that unrestricted net assets are not just piles of cash lying around to be used for whatever they want. The accounting term, which they admit is confusing, refers to any money that doesn't have some specific restriction placed on it by a donor. That includes a whole host of different funds, most of which have been designated for some purpose, they say.

The term could soon prove to be a headache for more state university administrators as lawmakers scour financial statements for any penny they can find to plug state budgets, and groups like students and faculty members are asked to share the sacrifice of budget cuts through tuition increases, cuts to services, pay freezes, and layoffs.

"This is a question that comes up all the time," said Karen Craig, a technical consultant for the National Association of College and University Business Officers. "It's easy to look at a financial statement and say, 'What's going on there?' "

Because universities differ so greatly in size, have such different functions, and cover such different costs, officials said they couldn't give an amount of unrestricted net assets or percentage of a budget that would be ideal. Doug Beckmann, senior associate vice president for business and finance at the University of Illinois system, which has a budget of about $4 billion, said a for-profit company with a similar budget would probably be happy with at least $500 million in unrestricted assets.

Because of the unclear nature of the term, unions and public officials can relatively easily suggest (and many will believe that) a college or university is crying wolf about its dire financial conditions. In order to combat the perception that they are sitting on large cash reserves – which often amount to hundreds of millions of dollars at large institutions, and sometimes more than a billion at institutions with health care systems – budget administrators acknowledge that they will have to explain the semantics of these funds.

"Everybody's saying 'Don't accumulate assets, pay me!' " Beckmann said. "That's why we've got to be careful that we tell the story."

Where the confusion arises is over the word "unrestricted," a term that grows out of accounting practices. In for-profit businesses, the difference between assets and liabilities would be the company's equity. Nonprofit and government organizations like colleges and universities do not have owners or shareholders to control the equity, so for these organizations, the difference between assets and liabilities is called net assets. Those that have state- or donor-mandated purposes fall into the "restricted" or "temporarily restricted" assets category. The rest are "unrestricted."

University administrators really don't like that term. They call it misleading because, while the money doesn't have the legal restrictions that come with a directed donation, most of it is already allocated for some purpose. It might have been set aside to pay for current or future construction projects, scholarships or fellowships, buildings and equipment, or a myriad of other purposes. While these funds are not endowments, they are often invested in a similar manner, and may tied up in long-term investments.

"Just because something is called 'unrestricted' doesn't mean it's uncommitted," said Rick Fitzgerald, spokesman for the University of Michigan, which was scrutinized in a *Detroit Free Press* article for having about $1.8 billion in unrestricted net assets. About $1.5 billion of those assets are attributable to the University of Michigan health system.

According to **financial statements** Central Michigan University had about $228 million in unrestricted net assets last year. Of that, $94.4 million related to capital projects in various stages of development and $26.8 million related to debt stabilization and insurance reserves. "Also included are contractual commitments and normal working capital balances maintained for departmental and auxiliary enterprise activities," the report states.

The amount of "unrestricted net assets" that universities have on hand varies greatly. Large systems could have billions of dollars in unrestricted net assets at any given time. For fiscal year 2008, the University of California System had more than $5.3 billion in unrestricted net assets. The University of Cincinnati, on the other hand, had a deficit on its last financial statement. The money can come from a variety of sources, such as unrestricted donations or operating surpluses.

Central Michigan University, where the faculty union is currently negotiating a new contract, saw an an increase of almost $30 million from the previous year. The argument that the faculty union there is making is that in most cases, even if the assets are designated for a specific purpose, such as future construction, the fact that it is "unrestricted" means that it could theoretically be reallocated by the university's governing board for a different purpose, like salary increases.

Tim Connors, the union's president, said the university is hiding behind the claim that the money cannot be reallocated.

"We're trying to say to our members and the public is that looking at how they designate the unrestricted funds will show you the university's priorities," Connors said. "If buildings are receiving more money than anything else, we just want administrators to admit that."

He said that not all of the money can be shifted around, and he recognizes that some investments in the future are necessary. But he argued that investing in higher salaries to develop a world-class faculty would be the best investment in the future.

Their argument that the funds could be reallocated is legally correct, accounting officials say.

Because of this, it's easy for groups to argue that universities' unrestricted net assets are "reserves." In 2009 faculty members at the University of Maine used a report that showed growth in the amount of unrestricted net assets to **argue against cuts**. The same year, the Coalition of University Employees at the University of California commissioned **a report that looked into a similar pool of funds** and argued that the university was "hiding money."

"The University of California budget terminology obscures how resources available for educational and public service uses, including fairly paying clerical and allied services workers, many of whom are responsible for the university's day-to-day operations, are directed elsewhere," the report states.

The situation in Ohio, where the state's colleges and universities have about $3 billion in unrestricted net assets, is slightly more complicated. About a decade ago, the state legislature passed a law requiring universities to maintain a certain debt-to-income ratio. Chris Widener, a republican state senator and the finance committee chairman, is now wondering if that ratio was too high. Public universities are facing a 15 percent cut in state funding and are asking permission to raise tuition by 3.5 percent.

"As my colleagues and I work to fill the $8 billion deficit in our state budget, every dollar matters," Widener wrote in **a letter to the *Columbus Dispatch***. "Our questions about how the emergency funds are used are not to suggest that these institutions are wrong to conserve, nor to imply that these reserves should be consumed. But Ohioans will rightly expect us to justify the funds against any desire to raise tuition costs."

Bruce Johnson, executive director of the Inter-University Council of Ohio, which represents public colleges and universities in the state, said the money is often used as insurance on potential liabilities.

But just because the money can legally be reallocated doesn't mean it would easy to do, administrators argue. Nor does it mean that

doing so would be advisable.

While their universities haven't been targeted in the way that Michigan and Ohio have, officials at the University of Illinois system said their finances could easily come under scrutiny soon. The university's pool of unrestricted net assets jumped from $65 million in 2009 to $386 million in 2010. During this time, the university made significant cuts and furloughed staff and faculty members.

Part of that increase is a conscious effort to increase the pool, administrators said. The university has been routinely criticized by ratings agencies for not having enough assets that could be shifted around and for not holding the pool constant. In a 2010 assessment of the university, Moody's Investors Service wrote that the university's "unrestricted resources provide a razor-thin cushion of unrestricted financial resources for a university of this size and reputation ... with the state funding crisis exacerbating that weak coverage." Compared to other universities of its size, the $65 million in unrestricted net assets the university had in 2009 was small potatoes.

But most of the increase is attributable to accounting practices. Because of delayed state appropriations, the university had to shift money away from expenses into the net asset pool to cover other costs. That shift made the pool of unrestricted net assets count as more than usual.

"I wish this jump in unrestricted assets was just a jump in unrestricted assets," he said. "But the truth is we don't have it available to spend in any fashion."

While he did not give an exact figure, Beckmann said the university, which has a budget of about $4 billion, would ideally have "significantly more" unrestricted net assets to support salaries and other expenses. Getting there could come through increased tuition revenues or some other sustainable revenue source, he said.

Were a university to drain its unrestricted net assets to offset a large cut in state funding or to increase salaries for faculty members, administrators argue, it would be pulling money out of long-term investments, which would hurt the institution’s ability to construct new buildings, renovate old ones, hire new faculty members, and provide scholarships and fellowships over time.

Administrators argue that such a move could also hurt the university’s ability to receive credit in the future. “Unrestricted net assets are an important part of assessing a university's balance sheet strength and provide support for operating expenses, including debt service payments,” said Kimberly Tuby, a vice president with Moody’s higher education team. “A decline in unrestricted net assets could weaken a university's credit profile but might not necessarily result in a near-term rating downgrade if the university maintains strong student demand, positive operating performance and healthy fund-raising.”

Administrators also argue that the funds are designed to be an investment in the future. “We think that part of our mission is to do good work now, and part of our mission is perpetual,” said Fitzgerald, the University of Michigan spokesman. “If we’re going to serve that perpetual mission, some of this money should be retained.”

— **Kevin Kiley**