

POLICIES AND PROCEDURES FOR MAINTAINING AUXILIARY ENTERPRISE RESERVES AND INVESTMENT YIELDS

Auxiliary enterprises are activities operated by institutions to provide services to students, faculty, staff, and sometimes, the general public or special interest groups. They are operated as businesses, with the need to balance revenues and expenditures. Operating reserves are usually required due to the fluctuating nature of institutional revenue collections and the possibility of unanticipated events. Reserves to meet facilities and equipment needs are necessary to provide for longer-term maintenance and renewal and expansion needs of the institutions without a requirement for major fluctuations in fees and charges to students and parents.

A reserve is an undivided or unidentified portion of the net assets of an institution, in a stated amount, held for a special purpose. There are three categories of auxiliary enterprise reserves that are related to different expenditures or budgets.

1. Operating Reserves
2. Reserves for Renewal and Replacement
3. Reserves for Major Renovation, Acquisition, and Plant or Program Expansion

Some institutions may establish a fourth type of reserve to support the debt service requirements of long-term debt for specific projects approved by the General Assembly. Policies and procedures for establishing and monitoring such reserves are maintained by the Department of the Treasury.

OPERATING RESERVES

DEFINITION. The nature of auxiliary enterprises at each institution will influence the size of operating reserves necessary to provide for reasonable cash flows during a fiscal year and from year to year. The operating reserve should include amounts designated for working capital and for contingencies. The working capital component provides the operating resources required by the unit. This portion the reserve should be established at a level which ensures that the unit has adequate financial resources to meet seasonal operating expenses. The contingency component enables the unit to withstand dramatic financial events which could not have been anticipated. This portion of the reserve

establishes the minimum level of the reserve. Except in emergency situations, the balance in the operating reserve should never be less than the contingency amount.

SIZE OF RESERVE. In general, the average size of the working capital component of the operating reserve should approximate expenses required for 30-60 days, or between 6-18 percent of annual expenditures. The actual size of the reserve will fluctuate from month to month over the year. The size of the contingency component should approximate four percent of annual expenditures, or the equivalent of two weeks expenditures. Average annual operating reserves falling outside of these guidelines should be reviewed and justified on an institution by institution basis.

RESERVE FOR RENEWAL AND REPLACEMENT

Because auxiliary enterprises are required to be self-supporting and cannot depend on the general fund to renew and replace facilities, institution managers must have long-term strategies for maintaining auxiliary enterprise facilities. The strategies necessarily must coordinate the timing of revenues and expenditures. Incentives should be provided to these managers to minimize costs to students while encouraging them to establish prudent reserves to fund established long-term plans for renewal and replacement of facilities.

DEFINITION. The reserve for Renewal and Replacement (R&R) should include amounts set aside for expenditures needed to repair, improve, renovate or replace existing long-lived assets. As contrasted with the Major Renovation, Acquisition, and Plant or Program Expansion reserve, the R&R reserve is not used to accumulate resources for additions to plant. Expenditures from this category are of two types. First, repairs, improvements, and renovations to facilities, infrastructure and equipment are funded from this reserve. (Institutions may at their option fund major renovations from the Major Renovation, Acquisition, and Plant or Program Expansion Reserve.) The second category includes expenditures made to replace a component or sub-system of an existing facility. The critical test relating to funds in this reserve is whether reserves and expenditures relate to assets which are already owned.

SIZE OF THE RESERVE. The Maintenance Reserve Formula has served as the basis for appropriations to colleges and universities for educational and general facilities for several years. The same formula should be used to determine the expected level of expenditures for renewal and replacement of facilities and infrastructure for auxiliary enterprises. It automatically adjusts as new facilities are opened and existing facilities renovated. The calculation can be made from facilities information maintained in the Fixed Assets Accounting and Control System, building replacement values provided by

the Office of Risk Management, and related information provided by the institution. The average annual balance in this reserve should estimate the amount generated by the maintenance reserve formula calculation.

Further, within educational and general budget guidelines, an amount equal to eight percent of the replacement value of current equipment is identified as the normal amount necessary to maintain the current equipment base. This assumes that the equipment inventory will turn over every 12-13 years. A similar guideline can be used to estimate the level of expenditure required to maintain auxiliary enterprise equipment. Reserves should be sufficient to maintain annual equipment expenditures in auxiliary enterprises approximating ten percent of the replacement value of equipment included in the Fixed Assets Accounting and Control System. This assumes the equipment will turn over every ten years. A shorter lifespan is used for auxiliary enterprise equipment compared to that for educational and general equipment due to the nature of auxiliary enterprise activities.

RESERVES FOR MAJOR RENOVATION, ACQUISITION, AND PLANT OR PROGRAM EXPANSION

DEFINITION. The acquisition and expansion reserve should be used to account for funds accumulated to provide for the major renovation, construction or purchase of new facilities or equipment. Recent changes in the Commonwealth's debt financing policies encourage institutions to develop capital project reserves or sinking funds to reduce reliance on debt financing. Establishing capital outlay anticipation reserves for planned projects in advance of the initiation of the project will permit the orderly planning and initiation of fees and user charges. In some cases, the existence of cash reserves may influence the financial feasibility of a project and may reduce the long-term financing costs to the students and institution.

This fund may be used to establish reserves to initiate major new programs as well. For example, initial start-up funds may be needed to begin a new transportation system or to expand a women's athletic program.

SIZE OF RESERVE. The size of this reserve should be based on the individual needs of each institution. Funds should accumulate in this reserve for specific board-approved projects and needs only. Funds for acquisition and expansion should begin to accumulate no earlier than four years prior to the planned initiation date of the project.

INVESTMENT YIELDS

Revenues from investment yields associated with cash balances in the various funds should be credited to the institution monthly for the purpose of minimizing the costs of such services to students and other users. By crediting auxiliary enterprise reserves rather than educational and general appropriations, the benefit will accrue directly to the payors of such services rather than to the general student population which may or may not be using the services.

Institutions should be encouraged to maintain minimum balances required for efficient operations. But operating reserves should not have cash balances in excess of those needed to sustain the guideline levels of expenditure. (The maintenance reserve formula may not generate sufficient maintenance requirements in one year for institutions with small auxiliary enterprise operations. Such institutions should document their needs to maintain larger balances.) Balances significantly in excess of average guideline expenditure requirements will need to be justified or will not receive the benefit of the investment yield. Institutions should establish user fees to anticipate the addition of the investment yields.

No specific action to appropriate investment yields associated with operating reserves is necessary. The investment yield accruing to an institution's reserve account can be credited directly to the institution by the Comptroller. The appropriation for auxiliary enterprises must be sufficient to cover expenditures of any portion of the yields, however. This authority can be requested by the institution through the normal budget process.

ELIGIBILITY REQUIREMENTS

In order for an institution to be eligible to receive such yields, the institution must be recovering fully the cost of educational and general services provided for auxiliary enterprises, or have an otherwise approved indirect cost study. Institutions not recovering such costs will have the yield reduced by an amount equal to the under-recovery. If the yield is not sufficient to cover the under-recovery, an adjustment may be made to the educational and general appropriation to increase the level of recoveries. Determination of whether an institution is recovering such costs fully will be based on the most recently approved cost study submitted as part of the biennial budget process. The cost study and the annual report of actual auxiliary recoveries must be approved by representatives of the Council of Higher Education.

As part of the biennial budget process, institutions will submit documentation on the amount and purpose of each of the three reserve balances. The Council of Higher Education will determine, in consultation with the appropriate institution, the eligibility of such balances for the yield accumulation.