

**UNIVERSITY OF MASSACHUSETTS
RESERVES POLICY**

PURPOSE

To establish a policy that governs University reserve funds, the purposes for which they can be used, and associated reporting requirements.

I. INTRODUCTION

University of Massachusetts' ability to fulfill its mission for the benefit of current and future students depends on sound fiscal management and the maintenance of adequate University reserves. Reserves are critical to the financial health of the University, preserving future flexibility, and maintaining strong credit ratings. This policy establishes the framework for reserves including size, use and funding, as well as oversight and reporting requirements.

II. POLICY STATEMENT

- A. The University of Massachusetts will establish targets to maintain sufficient financial reserves in order to ensure responsible long-term fiscal management, advance University priorities, and mitigate current and future risk.
- B. The University of Massachusetts will define, build, maintain, use, and replenish reserves in accordance with campus strategic plans and the University's Reserve Policy and Standards.
- C. In order to distinguish between unencumbered liquidity and reserves that are designated for a specific use, the University will account for and report unrestricted net assets in the designations defined by this policy.
- D. The University President's Office shall maintain a Stabilization Fund to support university system operations in the event of an unanticipated disruption in planned funding or catastrophic event. The Stabilization Fund shall be built and held centrally at the President's Office. The President shall have the authority to establish and amend standards that specify the size and the funding source of the Stabilization Fund.

III. COMPLIANCE/REPORTING

The President or his/her designee will annually review this policy. Consistent with the University's Five-year Forecast and upon the release of the University's annual audited financial statements, the Board of Trustees will be provided a report regarding the University's reserve levels. The Board Chair shall be notified by the President when funds are drawn from the Stabilization Fund.

IV. ADMINISTRATIVE STANDARDS

The President, in consultation with the Vice President(s) and Chancellors, shall promulgate administrative standards to define reserve targets, funding sources, and designations, and to otherwise implement this policy.

PRESIDENTIAL STANDARDS FOR THE UNIVERSITY RESERVES POLICY (Doc. T18-026)

I. INTRODUCTION

This standards document provides additional detail related to the implementation of the Board of Trustees Reserves Policy (Doc. T18-026):

The President will issue additional guidance specifying the accounting treatment for each reserve designation and its use.

II. DEFINITIONS

In order to distinguish between unencumbered liquidity and reserves designated for a specific use, the University will account for and report unrestricted net assets in the designations defined below.

- A. Unexpended Plant & Facility Projects – Designated to fund capital projects, equipment and the major renovation of all existing infrastructure and buildings including Research, Education & General (“E&G”), and Auxiliary.
- B. Auxiliary Enterprises – Auxiliary enterprises are essentially self-supporting activities, which provide non-instructional support in the form of goods and services to students, faculty, and staff upon payment of a specific user charge or fee; this fund also includes the net position of Worcester City Campus Corporation (“WCCC”).
- C. Education & General – Maintained by departments to fund operational requirements, academic initiatives, research, faculty recruitment and University initiatives.
- D. Quasi Endowment – Portion of unrestricted net assets invested in the Foundation’s pooled endowment fund, intended to be invested for the long term unless otherwise approved by the President or a designated authority. The President or designated authority will contemporaneously provide notification to the Board.
- E. Stabilization Fund – Designated to provide budgetary stabilization for operations due to unforeseen and / or uncontrollable circumstances to ensure responsible long-term financial stability. Funds should be used for an unanticipated one-time disruption in funding or catastrophic event and shall not be used to cover operating shortfalls that could have been anticipated and managed.
- F. Other Unrestricted – Undesignated for a specific use or purpose; however, it does include the net position for the Independent Business Lines of the Medical School (examples: Commonwealth Medicine and Mass Biologics).

III. STANDARDS STATEMENT

Reserves should be funded primarily through budgeted and surplus operating funds. Other receipts may be deposited into reserves on a case-by-case basis. Funds allocated to a reserve designation shall be used for the designated purpose.

A. Unexpended Plant & Facility Projects

1. Unexpended plant and facility funds are generally used for the construction, renovation and acquisition of the University's assets. They are used to fund campus infrastructure needs related to capital projects, equipment, new construction and the renovation of existing buildings including, but not limited, to those used for research, auxiliary enterprises, student life, and education and general purposes.
2. *Maintaining Unexpended Plant & Facility Reserves*
Annual contributions shall made in accordance with the University's Capital Planning, Land and Facility Use Policy (Board Policy T93-122, as amended).

The funding and use of reserves should align with the capital investments necessary to meet the facility lifecycle cost analysis, which shall be performed annually by a third party, and the University's deferred maintenance backlog. Campuses should consider the lifecycle costs associated with facility projects beyond the initial design and construction expenses when contributing to this reserve. Funds should be set aside and used for long-term costs associated with maintaining new facilities.

3. *Use of Unexpended Plant & Facility Reserves*
The University of Massachusetts maintains a system-wide five-year capital improvement plan. Projects supported by these funds, at a minimum, should meet the requirements set forth in the University's Capital Planning, Land and Facility Use Policy (Board Policy T93-122, as amended). It is expected that funds will fluctuate throughout the fiscal year as campuses make contributions and spend from these reserves.

When expending funds from this reserve, campuses should prioritize projects that meet the annual asset reinvestment or "Catch Up" spending targets as defined in the University's Capital Planning, Land and Facility Use Policy.
4. The University President shall define "Keep Up" and "Catch Up" targets and promulgate standards in accordance with the Capital Planning, Land and Facility Use Policy to ensure that campuses are making progress toward meeting the deferred maintenance needs of its facilities.

B. Auxiliary Enterprises

1. *Maintaining Auxiliary Reserves*
Generally, auxiliary enterprise is an entity or unit that exists predominantly to furnish goods and services to students, faculty, or staff and that charges a fee directly related to, although not necessarily equal to, the cost of goods or services. The public may also be served by some auxiliary enterprises.

Campuses are responsible for ensuring the programmatic and fiscal soundness of their auxiliary operations and maintaining adequate reserves. It is recommended that campuses have a multi-year budget plan in place to ensure that adequate, but not excessive, reserves are maintained. The President's office will annually review the plan.
2. *Use of Auxiliary Reserves*
Reserves should be linked to specific programmatic and operating needs and they should be accumulated to meet debt service requirements where necessary, to ensure that equipment and

facilities can be maintained, replaced, remodeled or refurbished as needed, and to provide an operating cushion to offset short-term revenue losses or unanticipated expenditures. Campuses should consider the lifecycle costs analysis associated with capital assets supported by auxiliary revenues.

Any funding used from these reserves to support capital improvements shall be transferred and expended from the Unexpended Plant and Facility reserve.

C. Education & General

Maintained by campuses to fund operational requirements, academic initiatives, research, faculty recruitment and other University initiatives. Generally, education and general funds should be used in the most efficient and effective manner to advance the academic mission of the University and promote the high quality academic and student programs, and research. Any use of education and general reserves related to capital shall be transferred and expended through the unexpended plant and facility reserve.

D. Quasi Endowment

The University has made a commitment to grow its endowment funds. The Quasi Endowment Policy (Board Policy T07-018, as amended) establishes how the University and campuses collectively seek this growth through a combination of contributions to both the true and quasi-endowment funds. Annually, each campus shall be required to grow their endowment funds through a combination of donor contributions and unencumbered unrestricted operational fund transfers as quasi-endowment funds.

E. Stabilization

1. *Maintaining the Stabilization Reserve*

The University's Stabilization Reserve should have sufficient funds to cover immediate costs for University expenses in the event of an unanticipated one-time disruption in funding. In accordance with industry best practice, a Stabilization Reserve should be approximately one-month of operating expenses for the University.

The Stabilization Reserve will be held centrally and will be funded with unspent funds from the annual assessment. The University Controller will deposit 70% of any remaining balance from the annual assessment on campuses into the Stabilization reserve. The remaining 30% will be transferred into a fund to support University initiatives. Other one-time receipts may be deposited into the fund on a case-by-case basis with the approval of the Senior Vice President for Administration and Finance.

2. *Use of Reserves*

The Stabilization Reserve shall only be used in the event of a one-time disruption in funding due to economic uncertainty, adverse market conditions, cyclical recession, catastrophic interruption of service, or other unanticipated volatility in the operating environment. Funds shall not be used to cover operating shortfalls that could have been anticipated and managed.

Any request to draw funds from on the Stabilization fund shall be made in writing to the President. The President shall approve any use or transfer of funds from the Stabilization fund

and shall notify the Board Chair in writing within seven days or as soon as administratively reasonable.

3. The Stabilization Reserve will not replace insurance coverage. The University will continue to maintain coverage in accordance with the risk management and insurance program managed by the Treasurer's Office. However, the University should maintain sufficient funds in the Stabilization Reserve necessary to pay insurance claims within the applicable deductibles.

F. Other Unrestricted

Generally, these funds are not designated for a specific use, however, it does include the net position for the Independent Business Lines of the Medical School (examples: Commonwealth Medicine and Mass Biologics). Any use of other unrestricted reserves related to capital shall be transferred and expended through the unexpended plant and facility reserve.

G. Transfers

The University Controller will provide campuses with instructions and guidance for quarterly reporting of their unrestricted net position (URNP).

1. FINANCIAL RATIOS & BENCHMARKS

The University shall seek to maintain sufficient wealth and liquidity in order to ensure overall financial health, maintain strong credit ratings and withstand periods of volatility in its operating environment. The University will monitor the following financial ratios and benchmarks, in combination with ratios required in other policies and standards.

- A. **Total Cash & Investments** – a direct measurement of absolute wealth and the assets that generate investment income.

Calculation*	Aa2 Target Range
<i>University Cash and Investments – Debt Service Reserves</i>	< 2,500,000,000
<i>+Foundation Cash and Investments – Assets Held on Behalf of Others</i>	≥ 100,000,000

*University Cash & Investments include the following lines from the Statement of Net Position: Cash and Cash Equivalents, Cash Held by State Treasurer (Current), Short-Term Investments, Cash Held by State Treasurer (Noncurrent), and Investments. Foundation Cash & Investments include the following lines from the “Related Organizations” column of the Statement of Net Position: Cash and Cash Equivalents and Investments.

- B. **Spendable Cash & Investments to Operating Expenditures** - indicates the extent to which the University can rely on wealth that can be accessed over time or for a specific purpose to operate without earning any additional revenue. This measure is of particular importance during periods of financial stress when revenue may be subject to volatility.

Calculation	Aa2 Target Range
$\frac{\begin{aligned} &(\text{University Cash and Investments} - \text{Debt Service Reserves} \\ &+ \text{Foundation Cash and Investments} - \text{Assets Held on Behalf of Others} \\ &+ \text{Foundation Pledges Receivable Reported in Permanently Restricted Net Assets} \\ &\quad - \text{University Permanently Restricted Net Assets} \\ &\quad - \text{Foundation Permanently Restricted Net Assets}) \\ &\text{-----} \\ &(\text{Total Operating Expenses} - \text{Scholarship Expense} + \text{Interest Expense}) \end{aligned}}$	$\begin{aligned} &< 5.50 \\ &\geq 2.00 \end{aligned}$

- C. **Spendable Cash & Investments to Total Debt** - highlights the ability of the University to repay bondholders from wealth that can be accessed over time or for a specific purpose.

Calculation	Aa2 Target Range
$\frac{\begin{aligned} &(\text{University Cash and Investments} - \text{Debt Service Reserves} \\ &+ \text{Foundation Cash and Investments} - \text{Assets Held on Behalf of Others} \\ &+ \text{Foundation Pledges Receivable Reported in Permanently Restricted Net Assets} \\ &\quad - \text{University Permanently Restricted Net Assets} \\ &\quad - \text{Foundation Permanently Restricted Net Assets}) \\ &\text{-----} \\ &(\text{Total Outstanding Bonds} + \text{Capital Leases} + \text{P3 Debt}) \end{aligned}}$	$\begin{aligned} &< 3.00 \\ &\geq 0.75 \end{aligned}$

- D. **Operating Margin** - indicates whether total operating activities resulted in either a surplus or deficit as a percentage of the budget.

Calculation	Aa2 Target Range
$\frac{\begin{aligned} &(\text{Operating Revenue} + \text{Government Appropriations} \\ &+ \text{Gifts} + \text{Endowment Income} + \text{NonOperating Federal Grants} \\ &+ \text{Investment Income Net of Unrealized Gains and Losses}) \\ &\text{-----} \\ &(\text{Total Operating Expenses} + \text{Interest Expense}) \end{aligned}}$	N/A

- E. **Operating Cash Flow Margin** - compares net income before non-cash expenses relative to operating revenue to indicate the amount of cash the University generates to support its strategic and capital investments.

Calculation*	Aa2 Target Range
$\frac{\begin{aligned} &((\text{Operating Revenue} - \text{Scholarship Expense} + \text{Government Appropriations} \\ &+ \text{Normalized Investment Income} + \text{NonOperating Federal Grants} + \text{Gifts}) \\ &\quad - (\text{Operating Expenses} - \text{Scholarship Expense}) \\ &+ \text{Interest Expense} + \text{Depreciation Expense} + \text{Large NonCash Expenses}) \\ &(\text{Operating Revenue} - \text{Scholarship Expense} + \text{Government Appropriations} \\ &+ \text{Normalized Investment Income} + \text{NonOperating Federal Grants} + \text{Gifts}) \end{aligned}}{\quad} * 100$	$\begin{aligned} &< 20 \\ &\geq 11 \end{aligned}$

*Normalized Investment Income = three year average of total cash & investments multiplied by 5%.

2. COMPLIANCE/REPORTING

The President or his/her designee shall annually review the University's compliance with this policy. Consistent with the University's Five-year Forecast and upon the release of the University's annual

audited financial statements, the Board of Trustees will be provided a report regarding the University's reserve levels.

The President shall notify the Board Chair when drawing funds from the Stabilization Fund.

3. ROLES & RESPONSIBILITIES

The Board of Trustees shall establish a University Reserve policy. The President will issue standards and approve, where specified, the use of reserves. The President or his/her designee will annually review and report to the Board the University's reserve level. Chancellors have the responsibility to implement and manage to the policy and standards.

4. OTHER POLICIES

This policy should be reviewed along with the following policies and reports:

- University Debt Policy – T09-050
- Capital Planning, Land and Facility Use Policy – T93-122
- Quasi Endowment Policy – T07-018
- Report - Annual 5-year Financial Forecast
- Report - University's Annual Operating Budget