

University of Maine System

DRAFT Administrative Practice Letter (APL) on Reserves

For Discussion with the Finance, Facilities, and Technology Committee

A. Introduction to UMS System and Campus Level Reserves

Reserves represent an accumulation of funds set aside for future purposes. A subset of Unrestricted Net Position (UNP) in the audited financial statements, reserves represent the net accumulated surpluses and deficits from prior years' general operations and transfers.

Campuses and the System aim to maintain positive reserve balances to support long-term financial stability. They generally use reserves for the following purposes:

- Addressing unexpected revenue shortfalls (e.g., reductions in anticipated state appropriations);
- covering unforeseen expenses (e.g., one-time legal fees, major disasters); and
- supporting strategic, one-time investments and initiatives.

Both the System and individual campuses hold reserves, with the sources and uses described in the sections below.

This APL does not apply to unrestricted balances associated with projects, programs, and designated activities (i.e., general ledger funds 04, 12, 13, 18, and 19).

B. System Held Central Reserves

As described below, the UMS Vice Chancellor for Finance and Treasurer manages System held central reserves to support system-wide and campus initiatives, in alignment with this APL and the direction of the Board of Trustees. These reserves help the System respond to unforeseen state economic conditions or other fiscal challenges, cover unexpected costs, and fund strategic initiatives. The System also maintains these reserves to support its self-insured employee benefits and other insurance programs, as needed.

Annually, the UMS Vice Chancellor for Finance and Treasurer submits a report to the UMS' Finance, Facilities & Technology (FFT) Committee detailing all transfers to and from the System held central reserves during the prior fiscal year.

System held central reserves include the following subcategories.

1. Budget Stabilization Reserve

The UMS established the Budget Stabilization Reserve to manage the financial impacts of adverse investment markets, State of Maine economic conditions (i.e., State budget

curtailments), and other financial challenges. Campuses may draw on this reserve only when necessary expense reductions would jeopardize campus stability. Use of the reserve requires approval from both the FFT Committee and the full Board of Trustees during the annual budget process.

The UMS funds this reserve from Operating Fund net investment income that exceeds the budgeted amount. The target balance for this reserve equals 10% of the State of Maine's General Fund E&G appropriation to UMS for the prior fiscal year.

2. Unified Operating Reserve

The Unified Operating Reserve supports non-budgeted emergency needs. This reserve funds strategic investments that promote system-wide growth, stimulate reform, expand programs benefiting the System as a whole, and cover unexpected legal settlements. Examples of prior uses include funding library subscriptions and acquisitions across the UMS and necessary renovations at newly acquired buildings. The target balance for this reserve is 15% of the State of Maine's General Fund E&G appropriation to UMS for the prior fiscal year.

3. Benefit Pool Carryover

The UMS maintains the Benefit Pool Carryover Reserve to manage major cost fluctuations associated with its benefit plans, including its self-insured health plan. Transfers to and from this reserve typically reflect the actual performance of the UMS-wide benefit pool operated by GUS.

Based on the UMS actuary's recommendation, the target balance for this reserve should be sufficient to cover three to six months of expected paid health claims and expenses.

4. Risk Management Reserves

The Risk Management Reserves serve as business insurance reserves to assist campuses in paying deductibles on claims as UMS utilizes high insurance deductibles to reduce insurance premium costs. Annual campus contributions fund these reserves.

5. Capital Planning Reserves

The System primarily uses Capital Planning Reserves to fund information technology (IT) equipment and systems, and other capital equipment acquisitions.

6. Special Appropriation Reserves

The State's General Fund allotment of appropriation includes earmarks for initiatives such as Early College, Adult Degree Completion, etc. The System transfers any surpluses or deficits from these specific initiatives to the applicable reserve.

C. Campus Reserves

Generally, each campus maintains three types of reserves: operating, capital planning, and special or strategic investment.

1. Operating Reserves

Campuses maintain Operating Reserves to sustain financial operations during periods of unanticipated, significant unbudgeted operating expenses and/or reductions in operating revenues. These reserves provide resources to:

- respond to changes in the economic environment;
- sustain operations through temporary revenue setbacks caused by enrollment declines, funding reductions, or other issues; and
- preserve stakeholder confidence in campus fiscal management.

Campuses should use Operating Reserves to address short-term income and expense issues, not to resolve structural budget deficits. Use of these reserves should be temporary and serve to offset income shortfalls while the campus rebuilds or replaces revenue or reduces expenses in the near term.

Campus management should be prepared to annually report on their progress in meeting the Operating Reserve benchmarks established in this APL.

Each campus maintains a separate Operating Reserve for educational and general (E&G) operations and for each auxiliary enterprise:

a. E&G Operating Reserves

Each campus will work to establish and maintain an unrestricted Operating Reserve of at least 20% of its prior year Adjusted E&G Expenses – see ATTACHMENT I for illustration. A 20% E&G Operating Reserve would provide coverage for approximately ten weeks of E&G expenses.

At the end of each fiscal year, the net surplus or deficit ((revenues plus transfers in) less (expenses plus transfers out)) from E&G operations for each campus, will close to the respective campus' Operating Reserve.

When a campus seeks to use its E&G Operating Reserve and the balance is below, or will drop below, the 20% target, campus leadership shall submit a detailed proposal outlining the intended use of funds and a plan for replenishment to the UMS Vice Chancellor for Finance and Treasurer for review and approval. As part of this process, campus management shall evaluate other available categories of unrestricted and restricted net position to determine whether alternative funding sources are available and appropriate.

b. Auxiliary Operating Reserves

Each campus shall maintain an operating reserve for each major auxiliary enterprise operation (e.g., bookstore, residence and dining, motor pool). At the end of each fiscal year, the net surplus or deficit—calculated as revenues plus transfers in, less expenses plus transfers out—from each auxiliary enterprise operation shall automatically close to the corresponding Auxiliary Operating Reserve.

Each campus shall work to establish and maintain for each auxiliary operation, an unrestricted reserve of at least 20% of each respective operation's prior year Adjusted Auxiliary Expenses – see ATTACHMENT II for illustration. A reserve at this level provides coverage for approximately ten weeks of operating expenses for the respective auxiliary.

When a campus seeks to use an Auxiliary Operating Reserve and the balance is below, or will drop below, the 20% target, campus leadership shall submit a detailed proposal outlining the intended use of funds and a plan for replenishment to the UMS Vice Chancellor for Finance and Treasurer for review and approval. As part of this process, campus management shall evaluate other available categories of unrestricted and restricted net position to determine whether alternative funding sources are available and appropriate.

Campuses must clearly link any auxiliary reserve balance exceeding the recommended 20% threshold to specific programming and operating needs. Examples include planned capital expenses (including deferred maintenance) or reduction of fees and charges in the next fiscal year's operating budget. The campus Chief Business Officer (CBO) must review and approve such plans annually. Ideally, campuses should transfer amounts designated for planned capital expenses to an auxiliary capital planning reserve within the applicable auxiliary department.

2. Capital Planning Reserves

Campuses maintain Capital Planning Reserves to support future repair, renovation, demolition, or acquisition of real property, information technology (IT) equipment and systems, and other capital equipment. Each campus holds these reserves centrally; however, departments or colleges may also maintain equipment reserves when they can demonstrate a clear need and present a defined plan for timely use of the funds.

Each campus shall maintain separate capital planning reserves for E&G versus Auxiliary Enterprise operations. Campuses may hold the Auxiliary Enterprise capital planning reserve centrally or within the specific auxiliary unit for which the funds are designated.

3. Special or Strategic Investment Reserves

Special or strategic reserves are critical to a campus' ability to ensure the long-term stability of on-going programs or to fund new strategic investments. Establishing a new special/strategic reserve or adding to an existing one requires approval of the UMS Vice Chancellor for Finance and Treasurer. Generally, a campus should not make such a

request if its E&G Operating Reserve balance is below 10% of its Adjusted E&G Expenses. Campuses are encouraged to build their E&G Operating Reserves to the 20% of Adjusted E&G Expenses target before requesting special or strategic reserves.

Illustration – Calculating E&G Operating Reserve Target Balances

	<u>\$ in thousands</u>	
Fund 00 expenses and transfers*	\$	277,800
Less depreciation expense*		(18,630)
Plus debt service principal*		<u>3,078</u>
Adjusted E&G Expenses	\$	262,248

Operating Reserve Target Balances:

Minimum Reserve Balance to be Reached Before the Campus Requests Special or Strategic Investment		
Reserves = 10% of Adjusted E&G Expenses	\$	26,225
Target Minimum Operating Reserve Balance - 20% of Adjusted E&G Expenses		
	\$	52,450

* = Per the final STATS3EN_UNRES_EG report for the applicable fiscal year

Illustration – Calculating an Auxiliary Operating Reserve Target Balance for a Residence & Dining Operation

	<u>\$ in thousands</u>
Total Net Expenses for individual auxiliary operation*	\$1,836
Less balance in account 71699-Transfers to Aux Res YE Close'	<u>\$668</u>
Adjusted Auxiliary operation expenses	\$ 2,504
Auxiliary Operating Reserve Target Balance:	
Target Minimum Auxiliary Operating Reserve Balance - 20% of Adjusted Auxiliary Expenses	\$ 501

Above illustration is based on the below noted residence and dining departments for UMPL.

	<u>Dept 7501106</u>	<u>Dept 7701300</u>	<u>Dept 7701312</u>	<u>Dept 7000090</u>	<u>Dept 7000091</u>	<u>Total</u>
Total Revenue*	\$ (59)	\$ 801	\$ 1,009	\$ 9	\$ -	\$1,760
Total Net Expenses for individual auxiliary operation*	\$ (54)	\$ 871	\$ 1,010	\$ 9	\$ -	\$1,836
Less balance in account 71699-Transfers to Aux Res YE Close'	\$ 367	\$ 455	\$ (207)	\$ 35	\$ 18	\$668
Adjusted Auxiliary operation expenses	\$ 313	\$ 1,326	\$ 803	\$ 44	\$ 18	\$2,504

* = Per GL Inquiry view. Does not include depreciation expense.