October 7, 1997

Senator LeRay L. McAllister
296 East 1864 South
Orem, UT 84058

Subject: **Higher Education Non-Lapsing Balances** (Report #97-03)

Dear Senator McAllister:

In response to a legislative request, we have conducted an extended survey of the non-lapsing fund balances at five institutions in the state's higher education system. Although non-lapsing fund balances have grown 63 percent system-wide from fiscal year 1992 through fiscal year 1996, about half of the growth during that time can be associated with increased total revenues. In addition, the institutions we contacted generally provided reasonable explanations for growth in their balances. Also, other states' higher education systems have non-lapsing revenue sources. Our review of the uses of these non-lapsing balances in Utah indicates that uses are one-time in nature and reasonable. However, we have concerns about the adequacy of record keeping on balances at some of the institutions. In addition, we reviewed the liability for compensated absences and early retirement costs as it affects the reporting of non-lapsing balances. Information on fund balances and the liability can be reported more accurately to the Legislature.

Utah's system of higher education, comprised of nine institutions and the Board of Regents, is authorized to keep unspent state funds at year-end rather than return them to the state General Fund. These funds include state appropriations, special or supplemental appropriations, mineral lease funds, and tuition revenues, as well as fees charged by the institutions. Non-lapsing balances are authorized in the **Utah Code** in the Budgetary Procedures Act (63-38). Section 63-38-8(2) states in part that *"on or before July 31 of each fiscal year, the director of the Division of Finance shall close out to the proper fund or account all remaining unexpended and unencumbered balances of appropriations made by the Legislature...."* except certain funds, including *"college and university funds..."* and also *"funds encumbered to pay purchase orders issued prior to May 1 for capital equipment if delivery is expected before June 30..."* The law authorizes higher education to keep unspent fund balances and carry them forward into the next fiscal year without specifying any limit on the balance that can be carried forward or limiting the uses of the funds.

To provide legislators with more information on growth and uses of non-lapsing balances, this audit examined the non-lapsing balances at five higher education institutions. Addition- ally, we contacted other states to see whether they allow higher education to have non-lapsing balances, and whether Utah's are reasonable in comparison. We also reviewed the liability for compensated absences and early retirement to determine whether non-lapsing balances are being used to fund this liability. We obtained data and records from the Board of Regents as well as the University of Utah (U of U), Salt Lake Community College (SLCC), Utah Valley State College (UVSC), Snow College, and Utah State University (USU). Data were supplemented by discussions with Regents staff, faculty and staff at the institutions, and higher education finance staff in other states. Although a variety of fund sources make up total revenue in the higher education system, the largest is the Education and General appropriation, and thus, we focused our review primarily on the Education and General Fund balances.

Growth of Non-Lapsing Fund Balances Appears Reasonable

Non-lapsing or carry-forward funds in Utah's higher education system have grown from $23.1 million at the end of fiscal year 1992 to $37.7 million at the end of fiscal year 1996, a 63 percent increase. These figures reflect all state fund sources for higher education. During the same time, total available revenue for the system increased by 30 percent. Reasons for fund balance growth include the growth in available revenue as well as a variety of reasons specific to each institution surveyed. We believe that the explanations for growth in fund balances provided by the institutions are reasonable. In addition, comparisons with other states' higher education systems show that all the states which provided information have non-lapsing balances. Some of those states restrict the size or use of non-lapsing fund balances.

The following figure presents Utah's system-wide non-lapsing fund balances over five years as a percentage of total available state funding.

Figure I
System-wide Non-Lapsing Balances, FY92-96

Fiscal Year	Non-Lapsing Balance	Total Available Revenue	Balance as Percent of Revenue
1991-92	$23,118,446	$472,884,551	4.9%
1992-93	30,393,296	510,530,263	6.0
1993-94	27,427,214	542,750,992	5.1
1994-95	34,916,743	586,085,771	6.0
1995-96	37,696,466	614,151,137	6.1

System-wide growth in non-lapsing balances from fiscal year 1992 through fiscal year 1996 was 63.1%. Growth in revenue during the same time was 29.9%.

Figure I shows that, overall, non-lapsing balances as a percentage of total available revenue have increased slightly over the last five years from just under 5 percent to just over 6 percent. In addition, some of the other states we contacted provided information on their non-lapsing balances as a percent of revenues. These ranged as high as 15 percent held in balances. Nine states reported how their non-lapsing balances compared to total revenues; 4 states (44.4 percent) were maintaining around 1 percent in balances, 3 (33.3 percent) held from about 3 to 6 percent (a range similar to Utah's), while 2 (22.2 percent) held about 9 to 15 percent as balances.

While the note to the figure above indicates that the growth in non-lapsing fund balances has been greater than the growth in total available revenue, it is helpful to put the growth of the balances into perspective. If balances had grown at the same rate as the total revenue (30 percent), the system-wide non-lapsing balance at the end of fiscal year 1996 would have been $30,023,926. Thus, nearly half (over 47 percent) of the balances' growth since fiscal year 1992 may be attributed to the growth in revenue. Additional reasons for growth will be discussed in the next section.

Growth in non-lapsing fund balances varied widely at the five surveyed Utah institutions. We chose the institutions reviewed for this audit for several reasons, among them significant growth in year-end fund balances or a comparatively high percentage of total revenue held as a balance. Figure II illustrates the size of the non-lapsing balance for fiscal year 1996, the

percentage of state funding that balance represents for the institution, and five-year growth in the balance for the institutions we reviewed.

Figure II
Fund Balances for Five Higher Education Institutions
Fiscal Year 1996

Institution	FY96 Non-Lapsing Balance	Balance as % of Revenue	FY92-96 Growth in Balance
Snow College	$1,795,925	12.3%	116.3%
Salt Lake Community College	6,156,968*	9.5	9.3
Utah State University	9,062,578	6.5	75.7
University of Utah	9,502,924	4.3	218.5
Utah Valley State College	1,290,196**	3.2	40.2

****** Balance above includes $2,758,771 internally set aside for the liability for compensated absences and early retirement; SLCC views this money as no longer part of the fund balance, but it remains unrestricted and undesignated.*
*** Balance above includes $991,438 internally set aside for the liability for compensated absences and early retirement; UVSC views this money as no longer part of the fund balance, but it remains unrestricted and undesignated.*

The above figure illustrates the reasons several of the institutions were included. Snow College has both high growth and a high percentage held in balances, SLCC has a comparatively high percentage of revenues held in balances, and the U of U has seen significant growth in its non-lapsing balances in the last five years. UVSC and USU were added to provide additional two- and four-year institutions for comparison purposes. It should be noted that Snow College, SLCC, and UVSC all saw decreases in total non-lapsing balances from fiscal year 1995 to 1996. Also, two institutions have taken steps to set aside informally some of their fund balances to cover the liability for compensated absences and early retirement, a liability that is largely unfunded in Utah's higher education system. However, these monies remain in the unrestricted and undesignated fund balance and thus are available for uses other than offsetting the liability for compensated absences and early retirement (even though the institutions intend them for covering the liability). Therefore, we have included the amounts as part of SLCC's and UVSC's balances. Funding the liability will be discussed in a later section of this report.

Once the patterns of growth and balances were seen, we asked each institution to provide information to explain those balances, which we present in the following section.

Surveyed Institutions Provided Reasonable Explanations for Growth in Balances

Generally, explanations for balance growth provided by the surveyed institutions appear reasonable to us. In discussing the reasons for growth seen in the various institutions' non-lapsing balances over the last five years, some common explanations were provided as well as explanations unique to a given institution. Reasons recurring in our discussions with the institutions included growth in total available revenue and receipt of special or one-time appropriations that came near the end of the fiscal year. Other reasons included deliberate saving to offset budget cuts or to allow for planned acquisitions. The following figure summarizes the main reasons given by the five institutions reviewed.

Figure III
Explanations of Non-Lapsing Balance Growth

Reason Given	Institution	Explanation
Increase in tuition revenue	SLCC, UVSC, USU	Higher than expected enrollment yielded increase in tuition revenues
Open salary lines	U of U	Positions not filled immediately increased ending balances
One-time or special appropriations	UVSC, Snow, USU	Not used by year-end because of special purpose or allocated late in the year
Offset budget cuts	U of U, USU	Managers deliberately putting off purchases to save funds in case of budget cut
Growth in fuel/ power reserves	Snow	Constructing new building put off energy conservation projects, so reserves grew
Saving to increase buying power	Snow	Deliberate saving to add funds to next year's budget to increase buying power

Explanations given by administration at each institution.

The U of U administration gave two main reasons explaining the growth in their non-lapsing balances for the last five years. The first is the deliberate managing of open personnel positions to allow funds to accrue, and the second is a campus-wide saving effort aimed at mitigating budget cuts. The budget director as well as staff in deans' offices told us departments are able to accrue some funds through management of unfilled positions. A temporary replacement (e.g., a teaching assistant or adjunct faculty member) for a faculty member who left is usually available at lower cost than a permanent tenure track faculty member. Since it may take up to a year to replace a permanent faculty member, these accrued funds show up in the department's fund balance. We reviewed year-end expenditure reports for three of the colleges within the university; these data showed some funds remaining in salary lines, confirming to some extent the assertion that open salary lines have contributed to the non-lapsing balances at the university. The second reason explaining growth is that departments are reacting to several years' worth of budget cuts imposed at the university because of tuition shortfalls. Both budget staff and department or college level faculty and staff indicated that departments are putting off some purchases and saving up funds to mitigate the budget cuts.

Snow College officials provided several reasons for the growth in their non-lapsing balances over the last five years. First, receipt of supplemental funding or one-time appropriations, either restricted in purpose or transferred from the Board of Regents late in the fiscal year, has contributed to year-end balances because the college does not spend the funds by the end of the year. Examples of these funds are a technology initiative and a four-year university center appropriation. We reviewed records at the Board of Regents and Snow College and found these appropriations in four of the last five years. Second, they asserted that fuel and power reserves have grown recently because of preoccupation with construction of a new building. Funds accumulated in the reserve due to a couple of mild winters and because the college postponed using some of the reserve on fuel efficiency and maintenance projects while the new building was under construction. We calculated a 159 percent increase in Snow's fuel and power reserve portion of the non-lapsing balances since fiscal year 1992. Third, administrative staff indicated that department staff save up from year to year to buy equipment such as computers and lab equipment. Fourth, they indicated that interest earnings were being generated where possible to provide additional funds needed to augment a non-personal services budget that has not been increased in years.

At SLCC, administration told us that several years of higher than projected tuition revenues caused the growth in their non-lapsing balances. SLCC had three years of higher enrollments than had been expected; a review of enrollment data and non-lapsing balance reports shows that these years correspond directly with the three years of greatest increases in the school's non-lapsing balances. Larger enrollments resulted in increased revenue, and since the budget for the college is based on projected enrollment, unexpected enrollments brought in surplus revenue.

At UVSC, reasons provided for growth in non-lapsing balances included unspent special appropriations and higher than projected tuition revenue. As previously indicated for other institutions, special or supplemental appropriations are sometimes transferred to the colleges late in the fiscal year and so may not be spent right away, thereby contributing to year-end balances. Additionally, UVSC also experienced some years with higher than expected tuition revenue with the result that the budget was based on less revenue than realized. Our review of enrollment and tuition revenue reports from UVSC confirmed that this was the case in four of the last five years. According to college financial staff, the additional revenue was not all spent immediately and so contributed to their year-end balances.

Utah State University provided similar reasons to explain their increase in fund balances. First, they also received supplemental funding late in the year that crossed over to the next year before being spent. Second, the university saw three years' worth of increased tuition revenue, resulting in some of this revenue feeding into balances as well. Third, review of enrollment and tuition revenue figures shows that as the increased enrollments gave way to fewer than expected students over the last few years, tuition shortfalls have occurred the past two years. University staff indicated they imposed a budget cut that has caused a ripple effect of less spending on campus. Staff explained that the first budget cut led to rumors of another cut to come; people have responded by saving up to withstand the second cut. This saving pattern has resulted in some increase in departmental balances.

Having obtained reasons for the growth of non-lapsing balances at the five institutions, we turned to other states to determine whether they provide non-lapsing fund balances to their higher education institutions and if so, whether those balances have been growing and to what uses they have been put.

Other States' Higher Education Systems Have Non-Lapsing Fund Balances

We found that other states allow for non-lapsing fund balances in higher education and growth of those balances is generally not subject to controls. One study in Texas provided a guideline on how much fund balance is considered to be a desirable operating reserve. Applying the guideline to Utah shows that higher education balances here are lower than the standard provided.

Higher education systems from 20 states responded to our Internet survey and indicated that non-lapsing fund balances in their systems are quite common. The following figure summarizes information gathered from the 20 states; note that not all states addressed the issue of growth in their balances.

Figure IV
Use and Growth of Non-Lapsing Fund Balances in Other States

Number	Percent	Description
12 of 20	60%	Have all balances designated non-lapsing
8	40	Have some fund balances as non-lapsing
4	20	Have restricted use to one-time purposes
3	15	Limit how much can be held in balances
8 of 20	40	Did not address the issue of growth
5	25	Balances holding steady or data were unavailable/insufficient to tell
4	20	Have seen growth in balances
3	15	Have seen decline in balances

Note that 8 states did not address growth issues.

As Figure IV shows, all 20 states have at least some fund balances that are non-lapsing. Sixty percent of the states have designated all fund balances as non-lapsing. When we asked about limitations on the uses of the carry-forward funds, 4 states (20 percent) indicated that non-lapsing fund balances are restricted to one-time uses, while 3 (15 percent) provide a targeted percentage or limit on how much can be held in a fund balance. Uses of balances in Utah will be discussed in the next section of this report.

It appears that Utah's system of higher education is similar to others in having non-lapsing balances which are often not subject to restrictions beyond what were intended in the appropriation of the funds. Because not all states addressed the issue of growth in balances, we cannot say whether Utah is unusual in the growth over time, but of the 12 states which did answer this question, a third saw increases in their balances.

A study of funds and fund balances in Texas' system of higher education provided a method of assessing what level of fund balance is "good." An available funds ratio was computed by dividing a fund balance by total expenditures and mandatory transfers, then multiplying the result by 12. This computation yielded the number of months an institution could operate on its fund balance, or reserves (i.e., how long an institution could operate if all other sources of income ceased). The study indicated this is a "widely used indicator" of the appropriateness of fund balances. KPMG-Peat Marwick and the National Association of College and University Business Officers (NACUBO) were cited as among the entities believing that an institution not running consistent deficits with a ratio of between 2.4 and 6 months should be considered in good financial condition. When we computed this ratio for the five Utah institutions included in this audit and for the system as a whole, we noted that none of the ratios exceeded 2.0, and only SLCC and Snow College's ratio exceeded 1.0. The available fund ratios for the Utah institutions we reviewed are reasonably low compared to this level of operating reserves.

Uses of Carry-Forward Funds Seem Appropriate

The uses of non-lapsing balances in the five institutions we reviewed are generally one-time in nature and reasonable. Large portions of balances are obligated for specific purposes such as outstanding purchase orders (usually one-time purchases) and required fuel and power reserves (reasonable because required), while uses of department balances we reviewed were one-time and instructionally related. Next, although whether a manager keeps or loses ending balances is a factor in year-end spending patterns, we found reasons other than having funding taken away help explain increased year-end spending patterns. Further, purchases appeared to be appropriate and reasonable.

To understand how the schools use their non-lapsing balances, we reviewed the year-end report on fund balances prepared by each institution for submission to the Board of Regents. This report (called the S-9) shows the total fund balance as of June 30 and then provides a breakdown of the commitments from the balance. The Summary of Fund Balances report (prepared by the staff of the Board of Regents from the submitted S-9s) shows that most institutions have similar commitments for the balances remaining at year-end in the Education and General Fund. For example, in fiscal year 1996 all had outstanding purchase orders, ranging from 10 to 27 percent of their balances. These are purchase orders that were in process prior to the end of the year for which the funds are considered obligated. In addition, three of the five reported fuel and power reserves, which are required to be held at a level of 10 percent of annual expenses. Other commitments included departmental balances for those schools which allow non-lapsing balances to stay with departments on campus. Finally, a category called "Other" commitments includes supplemental appropriations and other restricted funds. Examples of these are technology initiatives, library specific funding, and Americans with Disabilities funding to help institutions meet the legal requirements of the Americans with Disabilities Act.

The ability to have and use non-lapsing funds is important to the institutions. Several of the

buying power to meager current expense budgets. Staff at two institutions told us there have been no price level increases for years in the non-personal expenditure budgets (supplies,

lapsing balances are needed to cover non-personal services expenditures. While the budgets have increased at the institutions, staff indicated increases have been for new space costs and do not

for inflation are not included in budget preparations. They stated this forces agencies to reallocate their resources, in effect, to do more with less.

non-lapsing balances enables them to better manage their money. Precisely because of the inadequacy of non-personal services budgets, we were told, the carry-forward concept allows

year to afford such things as upgrading computers, or buying fax machines or lab equipment. One department chair mentioned that he was able to obtain better equipment by taking advantage of a

Others stated similarly that the ability to keep unspent funds from year to year meant they did not feel pressure to use up allotted funds prior to the year's end; thus, they could either make

when they worked at an organization without non-lapsing balances, they saw a rush to use up budgeted funds at the end of the year. These faculty felt that unnecessary purchases were

lose it.

Uses of Balances Generally Are

Beyond the categories of commitments listed on the S-9 report, we also reviewed uses of

are used for one-time purposes. Since fund balances are essentially one-time in nature, using them

At the University of Utah, balances are mostly controlled by the various departments on

lapsing balances, but we also found that when funds are used, they are used for one-time, not

The College of Engineering had a $926,000 year-end balance for fiscal year 1996; these funds are mostly controlled by the departments in the college. The dean's philosophy is that departments are responsible for their budgets and must manage their balances and deficits (if any) at their level. The dean also indicated that his departments have been saving because he warned them budget cuts would be coming. Other uses of the balances include moving offices to another building, covering the cost of teaching assistants, and paying start-up equipment costs for new faculty. Discussions with a sample of department chairs indicated that balances were used primarily for lab equipment, computers, and computer upgrades. In addition, we reviewed non-personal services transactions and purchasing records for several departments and found that many of the purchases made were for office equipment and supplies, computer lab equipment, and network supplies.

The College of Humanities does not allow its departments to control balances at their level; the dean's office administers these monies. Expenditure reports showed a $1.3 million balance for fiscal year 1996. The dean's practice is to retain some budgeted funds centrally until partway through the year. Needs are then assessed and the remaining budget and non-lapsing balances are given out to handle the needs determined to merit the funds. The dean indicated that the fund balance was mostly used to cover departmental deficits, adjunct faculty and teaching assistant costs not covered in the budget, budget cuts, and equipment and travel costs for faculty to attend conferences and present papers. Review of a spreadsheet maintained by the dean and her administrative assistant on the use of non-lapsing balances for fiscal year 1996 showed that these funds were used for the above listed types of expenditures, and also for recruitment costs for faculty.

The Eccles School of Business is presently running a deficit of $960,000, so it has a negative carry-forward balance. The dean has told the departments that budgets must be set up to provide for payment toward reducing the deficit. In addition, if they save money beyond the amount they agree to put toward deficit reduction, those funds can be kept at the department level. The dean indicated that virtually all their state money is being spent on salaries with nothing left over for non-personal expenditures (supplies, equipment, travel); our review of expenditure reports showed that balances remained in faculty salary lines but were more than used up to cover the beginning negative balance plus over-expenditures in non-personal expense areas.

Snow College leaves about half of its non-lapsing balances at the department level, and the other half goes into a centrally administered account. Discussions with some deans and department chairs revealed that the department-level funds have been used for computers, student counseling, faculty travel to conferences, lab equipment, and a fax machine. Funds held centrally are administered by the Vice President of Administrative Affairs, who reported that these funds are mostly used for unexpected expenses, such as repairing an air conditioning unit in a building, and covering departmental deficits and expenses incurred by the president. He also indicated he receives numerous requests for unbudgeted items from various departments, such as computers, a mower for the maintenance department, and furnishings for

balances. We did not review detailed transactions records at Snow College.

Administration at USU indicated that beyond the special appropriations with restricted uses,

sample of departments seeking approval to keep balances show that planned expenditures included computer hardware and software, services to students with disabilities, peer advising

Salt Lake Community College pulls unspent year-end balances into a number of centrally administered accounts under the control of the vice presidents. Generally, requests are submitted

administrators and review of the transactions from the accounts where non-lapsing balances are held show that a variety of special or one-time expenses are covered from these accounts. For

current expenses in academic departments, and faculty salaries for those teaching during the summer. SLCC's practice is to budget some salaries for summer instruction, with additional

salary expenditure was expense for a new program, and the vice president indicated this would be built into the budgeted summer salary costs the following year. The Vice President for Business

areas, the Vice President for Student Services used some funds for start-up costs for the college baseball team, student service organization cost overruns, peer counseling program promotion,

balance monies on software site licenses, computer consultants, and a grounding project for the campus telephone system. In addition to reviewing account transactions from the vice presidents'

and found that computer hardware and software, video editing equipment, office equipment, and a backhoe for the grounds department were purchased with these funds.

President and his council. Budget staff indicated that fiscal year 1995's balance was internally targeted to cover the liability for compensated absences and early retirement. Staff stated and

positive ending balance because we included in the total the funds internally earmarked for the liability for compensated absences and early retirement. UVSC staff view the amount they set aside for the liability as no longer available, even though it is still part of the unrestricted fund balance.

In addition to reviewing uses of balances, we looked at when non-personal funds were spent. We reviewed purchasing practices to assess whether spending patterns alter when departments lose their unspent balances and to assess the necessity of year-end purchases. This review was done because a "use it or lose it" pattern of increased year-end spending may lead to less effective use of funds if purchasing is dictated by the end of the budget cycle. The results of this review are presented next.

Increased Year-End Spending Is Affected by Numerous Factors

We found that increases occurred in year-end spending in institutions or departments which did not allow non-lapsing balances to stay at the department level. However, factors unrelated to an institution's approach to non-lapsing balances also may explain increased spending late in the fiscal year. In fact, increased year-end spending was also found in some departments that kept non-lapsing balances, though to a lesser degree. Purchases made at year-end were found to be reasonable for instructional and support purposes. Therefore, even though purchases increased at year-end, the increases do not indicate the presence of poor purchasing practices.

Department and division chairs as well as deans and vice presidents discussed their purchasing patterns and philosophy of using non-lapsing balances with us. Generally, we found that all believe keeping ending balances is a good management practice. Many expressed the belief that they and others would adopt a "use it or lose it" approach if ending balances were to be swept out of their accounts. Several mentioned the ability to carry balances forward enabled them to purchase better equipment or to buy at better prices since they could afford to wait. Conversely, some indicated that losing ending balances would provide an incentive to use up as much of their budget as possible. They indicated that spending all funds would not be difficult, since they always have more needs than funds; they would use up the budget on needed items, but perhaps not obtain the best price because of time pressure.

To test this information, we reviewed purchasing records or patterns at three of the institutions. To varying degrees, all three showed increases in non-personal spending late in the year. Explanations include factors beyond a "use it or lose it" approach.

We found that the colleges at the U of U have different approaches to carry-forward funds, and they also show different expenditure patterns. For example, in fiscal year 1996, the departments within the College of Engineering showed less significant increases in year-end expenditures than did the College of Humanities, which does not let its departments keep their ending balances. Eighty percent of departments in Humanities spent more than 25 percent of their

25 percent of their budgets in the final quarter, with one of those just over 25 percent. However, department chairs in Humanities indicated they are not spending just to use

seeing that funds can be stretched to cover needs.

At SLCC, which does not let the departments keep ending balances, a large increase in June

non-personal spending. While one department chair indicated he has observed a “rush” to spend near the end of the year, another said she felt no pressure to use up her budget. Administrators at

year-end increase in purchases. First, a spending increase in June should be expected because the summer term is starting. Second, the push to close out the accounts by the end of June ensures

basis accounting system ensures that many transactions from previous months are processed in June. Third, many departments hold off on purchases until they see that their expenses in other

At UVSC, fiscal year 1996 expenditures showed significant increases during the last quarter of the year. We reviewed expenditures for five departments with larger budgets and found that

year. Budget staff at the college indicated that the late release of tuition revenue to departments in April, coupled with the release of funds from some unfilled positions at nearly the same time,

released to departments. Department chairs added that they are frugal throughout the year to ensure they have sufficient funds to cover expenses such as tutors, necessary supplies, and

purchases if funds remain. Several mentioned that they are unsure of their financial situation until late in the year due to untimely financial reporting, while one indicated that the receipt of

During our review of growth and use of non-lapsing balances, some concerns were noted that relate to the balances but less directly affect the growth and use issues we were asked to study.

Some Concerns Remain

Having found that the growth of non-lapsing balances is generally reasonable and uses to which these funds are being put are also reasonable, we identified a few concerns during the audit. First, reports to the Board of Regents and the Legislature can be improved. Second, tracking and record keeping of non-lapsing balances vary in the institutions. Because their management information systems are not set up to track fund balances separately, we have some concerns about the adequacy of record keeping at two of the institutions. Third, reliability or at least consistency of information from institution to institution is a concern. Finally, the liability for compensated absences and early retirement is unfunded in higher education; the Legislature needs to decide whether any action is needed in this area.

Reports on Non-Lapsing Balances Can Be Improved

Some of the reports presenting information on higher education non-lapsing balances should be reviewed with the goal of clarifying them. Reports presenting commitments from fund balances have been revised because of recent changes in reporting requirements related to the liability for compensated absences and early retirement. We believe these reports now give the incorrect impression that fund balances have been used to fund this liability across the system. In addition, the Board of Regents adjusted the operating budget requests used in the appropriations process during the 1997 legislative session to reduce institutions' non-lapsing balances by the amount of the liability without stating that amount in the document. Conse- quently, non-lapsing balances appear to be smaller than they are.

The Revised Summary Report Can Be Misleading. We are concerned that the Board of Regents' report, "Summary of Fund Balances as of June 30, 1996," presents an inaccurate picture of the non-lapsing balances at the state's institutions of higher education. This report was revised to show the liability for compensated absences and early retirement as a commitment from the fund balance of each school. However, the way in which this liability appears in the report suggests that fund balances are being used to cover the total liability at each school, which is not the case. Staff at the Board of Regents said the revised format was intended to reflect the fact that the liability is another commitment against the carry-forward but not to give the impression that the liability has been funded. Thus, the funds can be used for purposes other than the liability.

Prior to the fiscal year-end 1996 report, this summary report did not show the liability for each institution though some of the schools listed a portion of their fund balance as committed to accrued vacation leave or early retirement. According to staff at the Board of Regents, the report was revised to show various institutions' commitments from the non-lapsing balances in order to answer the need for more information. The liability for compensated absences and early retirement is a liability that must be shown on financial statements; it reflects the total amount that would need to be paid to employees for accrued leave and early retirement benefits if the institution were to close.

We have two concerns: First, listing the liability as the initial deduction from the fund balance at a school gives the impression that the liability has been funded from that balance. In fact, only

Eastern Utah--have internally set aside funds from their balances to cover the liability. Also, according to a manager in the State Auditor's Office, in order to fund the liability (versus

specific asset account to offset the liability. SLCC and UVSC both indicated they have internally earmarked the funds within the balance for the liability, but those funds remain in the unrestricted

their liability.

The second concern is that the report has become less helpful and informative instead of more

year 1996, but there is no clear indication of this amount in the most current version of the summary report. To illustrate how this lack of detail changes the picture given by the report, the

while on the second version the balance is a positive $1.5 million. We believe this is confusing, since the two reports are dealing with the same operational data.

Legislative Session. In addition to the Summary of Fund Balances report, the Operating Budget

also revised because of the unfunded liability. The amount of liability for each institution was removed from the balances listed in the operating budget requests without being specifically

without explaining that the missing amount is still part of the fund balance.

Before balances can be reported, they must be tracked or recorded somehow at the

Tracking of Non-Lapsing Funds Can Improve at Two Institutions

institutions' management information systems are not set up specifically to provide information on non-lapsing balances. Because the non-lapsing funds are not always separately identified or

funds.

The U of U's balances are carried forward in a specific budget area, or object code, but departments have different methods of accounting for their balances. Funds are brought forward in a specific area, then may be reallocated to cover over-expenditures in other budget categories. We found that year-end expenditure reports typically showed balances in the personal services budget areas and deficits in non-personal services. In effect, some current expenses were covered by funds remaining in salary lines. Since the balances were not tracked separately but simply became part of a department's funding, there was no record of when non-lapsing balances versus current appropriations were spent. One college within the university, however, maintained an informal internal spreadsheet that showed the dispersal of their non-lapsing balances. For the most part, we relied on discussions with deans and department chairs to obtain a better understanding of the uses of and approaches to non-lapsing balances.

Snow College allows some year-end balances to remain in department-level accounts but about half of the balances are centrally administered. At Snow, an assessment is made each year of which accounts' balances will remain and which will be taken centrally; as a result, there is not consistency in this practice from year to year. The Vice President for Administrative Affairs uses centrally held non-lapsing balances to eliminate deficits in some overspent accounts. Other overspent accounts take their deficits into the next year to be eliminated with the new year's funds. According to finance staff, the accounts that have their deficits eliminated change from year to year. The Vice President for Administrative Affairs also receives requests for funding and releases non-lapsing funds upon approval of those requests. According to the vice president, these funds are usually spent on unexpected or emergency needs. Budget change documents showing the transfer of monies are completed but do not specify the reasons for the adjustments, so these records do not track the use of balances versus other budget adjustments. Thus, other than our discussions with the vice president and his staff, we could not document the use of the centrally administered balances.

In contrast to these two institutions, the remaining three we reviewed have somewhat greater accountability of non-lapsing balances. USU has a written policy on non-lapsing balances that allows departments to keep 10 percent of base budget. Remaining balances beyond that are centrally held. If departments wish to keep balances in excess of 10 percent of their budget, written requests detailing the purposes for which funds will be used are required. Thus, USU maintains some record of the uses to which non-lapsing balances are put.

SLCC takes year-end balances to the vice presidents' level and puts them into an account under each vice president. This official then releases funds upon approval of requests from departments. Records are kept of the transfers from a vice president's account, so we were able to obtain information on both amounts and purposes for expenditures of non-lapsing balances. At UVSC, a similar process occurs. UVSC pulls ending balances back to the Education and General Fund, essentially for administration by the President and the central administration. According to the finance staff at the college, the president's council meets to decide which projects to fund with remaining balances.

Because the management information systems at the institutions are generally not set up to track or monitor non-lapsing balances as a separate entity, the accuracy or presentation of some

Our review of the Summary of Fund Balances (from S-9s) report prepared by the Board of Regents from data submitted by the institutions indicated that some commitments from carry-

fiscal year 1996 departmental balances of over $14 million on the S-9 for the Education and General Fund. However, the S-9 report listed the balance as just over $9 million. According to the university's budget director, the departmental balances were computed by

not the responsibility of the departments. The budget director indicated the primary difference between the $9 million and $14 million figures is a $4 million tuition shortfall that is carried in a

Additionally, while the expenditure report's ending balance was $2.8 million, the $9 million used for the S-9 came from a document titled General Fund Balance Analysis, so data came from

In a different area of concern, at Snow College we were unable to verify most of the reported information on non-lapsing balances. Administrators explained they could not locate the specific

records when moving from one building to another. They gave us a copy of the FBM048, but the data in this report did not match what they had reported as commitments from the balances. They

edition of the expenditure report they had used to extract the data on the report was no longer available, we are concerned that another version of the same report (also prepared after the close

The only component commitment from the college's non-lapsing balance we were able to verify was the outstanding purchase orders. At first we questioned even this amount because the S-9

last two years in a row. Staff provided the correct 1996 amount and corroborated it from balance sheets. However, they were unable to verify the fiscal year 1996 figure for fuel and power

not focused on maintaining a trail of their non-lapsing balances because it has not been an issue of concern until now.

If the use or growth of ending balances is of sufficient concern to the Legislature, consideration may need to be given to developing additional records or reports on non-lapsing balances and their use by the institutions. With some effort, most of the institutions were able to track their funds for us, but some could improve the record keeping of ending balances. Data are reported from a variety of sources at the different institutions, and comparable data may not always be submitted. Further, Board of Regents staff indicated that they normally do not verify data submitted by the institutions. Changes in the way the institutions track or record their ending balances would presumably not be without cost. Consideration would need to be given to the cost versus the expected benefit of adding additional reporting to track non-lapsing balances.

Other Concerns About the Unfunded Liability Exist

As we looked at the fund balances, we identified other concerns about the liability. These concerns are presented here for information purposes, with the suggestion that the Legislature consider whether any action is needed.

The liability for compensated absences and early retirement is a figure computed according to Government Accounting Standards Board (GASB) requirements; it reflects the total amount to be paid out for accrued leave and early retirement commitments if an organization were to cease operating. It is unlikely that one of the institutions in the higher education system will completely close. Therefore, one issue to be considered is whether the liability should be funded in its entirety, or whether some portion, such as an estimate of short-term payout, should be funded or specifically set aside. At present, state government (other than the higher education system) has provided itself a funding mechanism for this liability through dedicated tax revenues. According to the state's Division of Finance, when this funding mechanism was set up, no provision was made for funding the higher education system's liability. Therefore, another issue is whether some provision should be made to fund the liability for higher education.

It should be noted that the state and the higher education institutions are doing as much as they are currently required to do. Until GASB formally adopts a new basis for financial reporting, governmental entities are not required to fund the liability. GASB has not issued a full standard on funding the liability but has required that governments show the liability on their financial statements. In addition, certain disclosures are needed in the notes to the statements.

Because there is no clear mandate from GASB to guide what must be done, the Legislature needs to decide whether it is comfortable with the present status of funding the liability in higher education. Several options are available. First, the Legislature can require higher education to fund the total liability. This option requires consideration of where the money will come from. Second, the Legislature can require that higher education fund a percentage based on actual pay-outs in recent history or on some other basis such as an actuarial study. Third, the Legislature can leave the present situation as is until GASB issues its new reporting system which is supposed to

Legislature Has Options if Action Is Deemed Necessary

Our audit did not find criteria sufficient to indicate that the level of non-lapsing balances

with the way the institutions we reviewed are spending their non-lapsing balances. However, the review was complicated by the fact that the institutions generally do not track these carry-forward

in place regarding the use of non-lapsing balances. Informal controls do exist at other institutions, however. For example, staff at all the institutions told us that non-lapsing balances should be used

action, if any, is needed regarding these funds.

If better tracking of non-lapsing balances is deemed desirable, the financial reporting systems

future reviews. As previously mentioned, this tracking and reporting would entail costs not estimated in this audit. It should also be noted that no major problems were found in this review

reporting should be considered.

non-lapsing balances. For instance, a cap or upper limit on the percentage of available revenue that can be kept as a non-lapsing balance could be installed; this limit is in place in a few of the

example, to specify in intent language that non-lapsing balances can only be used for one-time uses. However, our observation is that the system is generally self-controlled in this area, so

In another area, our concerns with the recently revised reports, and the reliability of some of the data feeding into those reports, can be addressed within the system. The Board of Regents

summarize system-wide non-lapsing balances and those used to present budget requests to the appropriations committees during the legislative session.

absences and early retirement. The Legislature needs to determine whether funding the liability is needed and, if so, how to accomplish the funding since non-lapsing balances are mostly committed to other uses.

Recommendations:

1. We recommend that the Legislature determine if it wants the higher education system to implement additional record keeping and reporting on the source, growth, and use of non-lapsing balances. If this is determined to be desirable, we further recommend that consideration be given to the costs of imposing this additional reporting requirement on the institutions.

2. We recommend that the Legislature determine whether:
   a) it wants to put specific limits on the growth or use of non-lapsing balances in higher education, or
   b) institutions should be encouraged to develop policies on usage limitations for non-lapsing balances.

3. We recommend that the Board of Regents review the Summary of Fund Balances report and the format of the Operating Budget Request. These documents should indicate that the liability for compensated absences and early retirement is not being funded from the balances and should specify for each institution the amount of any deduction from a year-end non-lapsing balance.

4. We recommend that the Legislature review the issue of the unfunded liability for compensated absences and early retirement in higher education to determine whether it is desirable to fund the liability or some portion of it. If so, consideration needs to be given to finding a funding mechanism.

Regents is attached. If there is any additional information you need or if you have any further questions, please feel free to contact our office.

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Auditor General