



MEMORANDUM

Date: August 21, 2013

To: Rebecca M. Blank, Chancellor

From: Darrell Bazzell, ^{MB} Vice Chancellor for Finance and Administration

Subject: 2013-14 Base Budget Forecast

This update is intended to indicate how we are handling our carry-forward dollars from state and tuition support, with the intention of being fully transparent in our financial management at UW-Madison. We will provide additional updates should the financial picture change over the course of the year.

UW System Financial Administration has officially closed the books for Fiscal Year 2013, and we are now in a position to make reasonably certain estimates of projected carry-forward on our base budget state and tuition balances. We estimate carry-forward of approximately \$130 million for the UW-Madison campus. This is higher than the carry-forward in the prior year, which was \$102 million. This increase is primarily due to three items:

- The UW System transferred projected fiscal year 2013 savings on the utility fund to UW-Madison and other campuses. The final determination of the amount of such transfers was made late in the fiscal year. Some associated transfers were actually made after July 1, 2013, but are still reflected in UW-Madison's fiscal year 2013 carry-forward balance.
- Tuition revenue grew more than originally projected due to unanticipated enrollment shifts in UW-Madison's undergraduate population. It was not clear until December whether these enrollment changes were sustainable, so they were not built into the budget. Having now confirmed its sustainability, UW-Madison will fully expend the additional revenue on an annual, on-going basis.
- Tuition revenue grew as a result of implementation of several new self-supporting programs targeted at non-traditional students. These programs are just starting up and their expenditures are ramping up over this coming year as they hire staff. In the very near future, these funds will be fully expended.

While the projected carry-forward amount is relatively large, we will spend down most of this balance in the current fiscal year and over the course of the biennium. Much of the spend-down will be focused in two areas. First, the university must return \$45 million to the state over the biennium (as a result of the recent legislative budget cuts), which will require us to spend money from the reserves to cover critical, ongoing expenses. Second, due to the projected decline in federal research funding, we will have to shift a significant measure of continuing costs formerly funded by federal indirect cost reimbursement onto the base budget. 2012-13 was the first year since the UW System merger that federal indirect cost revenue actually declined. Research award numbers suggest that further reductions are certain and imminent. The research infrastructure funded by federal indirect costs must be protected as it supports UW-Madison's

Vice Chancellor for Finance and Administration

100 Bascom Hall University of Wisconsin-Madison 500 Lincoln Drive Madison, Wisconsin 53706-1380
608/262-9943 FAX: 608/263-7449

\$800 million per year research enterprise. Maintaining this vital enterprise and the economic impact it has on the State of Wisconsin is a critical priority and may require significant investment of base budget to offset reduced indirect cost revenues. This can substantially draw down the base budget carry-forward balance.

To give this issue historical context, it should be emphasized that year-to-year changes in the carry-forward balance are largely driven by variability in enrollments, particularly undergraduate enrollments. Over the previous five-year period, the university's carry-forward balance increased by approximately \$60 million. During that period of time, we faced variable undergraduate enrollment levels. For example, new freshman class enrollments ranged from below 5,700 to well over 6,200; total enrollments experienced similar variability.

Added to the uncertainty from a fiscal perspective were significant year-to-year shifts in resident vs. non-resident enrollment demographics. Although we spent some of the resulting tuition revenue growth on one-time priorities (such as additional course sections to accommodate the enrollment swings), we were reluctant to make permanent commitments because we were uncertain that the revenue growth was sustainable on a continuing basis.

Over the past two years, we developed and implemented a formal plan to counteract the underlying variance in enrollments by establishing specific, managed targets for all categories of students. This will allow the institution to convert revenue growth into permanent base commitments (as we did this year), which will significantly reduce the accumulation of carry-forward in the future.

While the university has clear commitments for the current carry-forward balance, the fundamental role that balances play in the institution's business operations must be recognized. The balance provides assurances against potential uncertainties with enrollment. If enrollments fall short, there must be a sufficient level of resources available to meet contractual obligations, pay instructors and provide services to students. More generally, the balance provides a contingency for emergencies, unanticipated costs or claims, midyear cost increases, and other unanticipated changes in fixed obligations, such as fluctuations in utility or fringe benefit costs. In addition, potential state budget reductions or rescissions, which have occurred in Wisconsin over the past decade, constitute an added level of financial risk that a balance can help manage.

The importance of using carry-over balances as a contingency resource is supported by a number of external professional organizations, such as the National Association of College and University Business Officers and the Higher Learning Commission (UW-Madison's accrediting authority), which establish industry financial management benchmarks (e.g. the Composite Financial Index and Primary Reserve Ratio). While we are proactively managing our balance to a level acceptable to state leaders and the general public, it should be noted that the university is well below the established benchmarks and peer institutional scores for these financial metrics.

As you know, we expect to work with legislative leadership and the Board of Regents to develop policies on balances that both recognize the legitimate role they play in financial management and meet the expectations of our broader constituencies and governing authorities. We anticipate that these policies will allow us to maintain reasonable balances that will protect the university in the face of operating and budget uncertainties.

Please let me know if you have questions or need clarification of any of the issues.