UNIVERSITY OF SOUTH CAROLINA
UNRESTRICTED NET ASSETS

The University's unrestricted net assets are assets with no external restriction as to use or purpose. They can be used for any purpose designated by the Board of Trustees, as distinguished from funds restricted externally for specific purposes. Unrestricted net assets result from accumulated excesses of revenue over expenses derived from University current fund operations. The University's unrestricted current funds are derived from state appropriations, student fees, institutional revenue and auxiliary operations that are not restricted for specific purposes. The unrestricted net assets are not all in a liquid form, like cash, but also include accounts receivable, pledges receivable, inventories and prepaid items among other classifications.

Unrestricted net assets include balances from operations of Education and General (E & G) activities, further defined below, auxiliary enterprises, quasi-endowments and unexpended plant funds. For the purposes of determining the unrestricted net assets from the USC annual operations, only Education and General funds should be used.

An auxiliary enterprise is an entity that exists primarily to furnish services to students, faculty and staff. Examples of auxiliary funds are the student health center, housing, parking, and athletics. By state law, auxiliary operations must cover their costs. Quasi-endowment funds are funds functioning as an endowment that are established by the institution from either donor or institutional funds, and will be retained and invested rather than expended. Since quasi-endowments are established by the institution rather than by an external source, the principal may be expended as designated by the Board of Trustees. Unexpended Plant Funds are used for the improvement or expansion of the physical facilities of the University. Expenditures may be for land and building acquisition, construction of new facilities, major rehabilitation, renovation, remodeling, and alteration of existing facilities; original equipment for new buildings and for expanded, remodeled, or altered parts of existing buildings; or general planning studies and surveys connected with the physical planning of the campus.

E & G funds are general operating funds and departmental funds which include:

A Funds – State appropriations, student tuition and fees (E&G portion), and campus-generated and other appropriated sources.

Departmental Funds are normally unit-generated involving Student Activities, Institutional Sales & Service, and unrestricted designated activities, gifts and scholarships.

D Funds – Student Activity Fees
E Funds – General Departmental (includes IDC recoveries from grants)
R Funds – Board of Trustees controlled funds from auxiliary funds
RP Funds – Departmental Private Gifts

Generally, the accumulation of unrestricted net assets is not a desirable goal in and of itself. The expectation is that the University will use its net assets to provide programs and services that will fulfill the goals and initiatives set forth by the University and annual budgeted operating revenues should equal budgeted expenses. According to the Association of Governing Boards Strategic Finance publication, the university must operate in “financial equilibrium” meaning that the institution not only has a balanced budget, but that the “projected rate of change in revenue and expenses are approximately the same, endowment use is limited to preserve its long-term
purchasing power, and that the annual operating budget is not balanced by deferring maintenance or other essential expenses, thereby creating hidden liabilities.”¹

In the course of annual operations, a limited amount of unrestricted net assets may be accumulated as reserves so that resources are available for emergencies that may arise. The unrestricted net assets should not be used to fund recurring operations; but, instead, are desirable to cover sudden shortfalls in revenue, unanticipated expenses, and extraordinary one-time investments. An excess of operating funds indicates the institution is meeting budgetary goals, but it does not show the relationship between the budget and the strategic plan. This surplus may be the result of a conscientious effort to retain a portion of operating revenue for use in future years.

Shortfalls in revenue may be the result of changes in enrollment or reductions of state funding. USC is largely dependent upon student tuition and fee revenue and must be able to endure an enrollment decrease that would take four or more years to recover. Further, increases in enrollment may require additional resources to strengthen faculty and student service offerings. Enrollment fluctuations are of particular concern to the USC system campuses. Enrollment management decisions weigh the multiple factors of class size, student quality, financial need and scholarships.

During the round of state appropriations reductions from 2001-2004, USC Columbia lost more than $46M and the system campuses lost more than $25M due to cuts. Although student tuition and fees were raised during the state’s economic downturn to maintain the Board of Trustees initiatives, budget reductions were spread across University units. Since the beginning of FY2009 through June 30, 2009, state appropriations were reduced by another $55M across the system. Additional mid-year reductions have been made in FY2010 including a 4.04% cut in September 2009 and a 5% cut in December 2009. To date, the latest fiscal crisis has led to reductions of more than $70M for the USC System Campuses. It is expected that additional reductions will be made in FY2010 should collections not recover and there remains a likelihood that base cuts will be made to start FY2011.

USC has experienced a significant increase in faculty hiring, both to replace retirements and to increase the total number of faculty serving students. Start up costs include renovating and upfitting labs and purchase of equipment, data and software. Uses of one time funds this year include faculty start up costs, academic support and student affairs programs and significant investment in security improvements.

In response to the fiscal crisis the University delayed the implementation of a comprehensive administrative computing system. The OneCarolina project is the University’s multi-year initiative to replace outdated administrative computing applications, including student information systems, finance, sponsored programs and human resources into one easily-accessible, web-based system. This process has been scaled back to cover only the student information system at this time, reducing the funding needed from more than $85M to approximately $55M. Through June 30, 2009 the University had $33.8M of the anticipated cost. Planning for the expenditures associated with this system allows the University to avoid externally financing the project by accumulating funds over a period of years in advance.

In addition to weathering changes in enrollment and appropriations and planning for expected changes in expenditures, the University must plan in the operating budget costs not supported by the state including a portion of the pay package increase and associated increase in fringe benefits. Other expenditures are increases in the employer contribution for the state retirement system to cover the COLA adjustments, TERI payouts of annual leave, the increase in the sales tax, and the increase in the minimum wage. Although this type of inflationary increase must be covered with recurring dollars, the availability of reserves allows careful planning to ensure that the effect of these changes is not beyond the current capacity to cover these costs.

The amount of unrestricted net assets and the change from year to year has an impact on the financial ratio analysis conducted by the credit rating agencies to determine if the financial condition of the University is adequate to support the existing operation and changes brought about through capital financing. These assets allow the University the ability to control the timing of entering the bond market through use of short-term internal financing. In doing so, USC is able to secure more favorable interest rates and minimize the use of capitalized interest for long-term financing.

The interest on the investment of the E & G funds from the University’s unrestricted net assets is a part of the State’s general fund. The University earns interest on auxiliary funds, quasi-endowments and the unexpended plant funds.

The University is engaged in a continuous, cyclical process of planning and budgeting, not for one year, but for multiple years. Decisions concerning maintaining, building or depleting financial resources impact the budgets for several years. The USC unrestricted net assets are committed to BOT initiatives.

Since the 2003/2004 fiscal year, USC Columbia completes an annual budget using the concepts of “value centered management” in the development of “A” Fund operating budgets. This action was recommended by the Strategic Directions and Initiatives (SDI) Committee. Each year, the University’s annual budget development process refines the initial assumptions by adapting the model so that the needs of the institution are met. Under this model all costs and income attributable to each academic unit are assigned to the unit. Costs include the unit’s existing programmatic budgets, as well as its share of the operating funds needed to support the University’s service functions. Income includes the unit’s existing departmental revenues, summer school revenues, transfers, carry-forward balances, and the tuition revenue generated from the student credit hours taught by the unit. State appropriations were allocated to academic units upon creation and revision of the budget model. Service unit costs are assessed to academic units based on a formula and/or the application of direct charges. Formula based assessments resemble a tax and once determined are fixed and must be paid.

USC’s Value Center Management is a form of Responsibility Centered Management that is intended to provide incentives for planning and cost effectiveness and revenue generation. Rather than a centralized budgeting model, VCM moves the budget decisions into each unit to provide local responsibility and authority presuming that those closest to the action make the best decisions. VCM provides academic units with the flexibility to match revenue streams with changing program needs and reduced the annual “use it or lose it mentality”, by assuring the units that they would retain their funds for planned commitments.
The University does not have a policy requiring a minimum total reserves ratio based on total reserves as a percentage of prior year revenue. However, some institutions do have a policy requiring a set percentage retained. The amount of unrestricted net assets retained is one of the resource allocation decisions considered when balancing needs with available funds. Are the funds sufficient, extensive or inadequate to cover planning and budgeting? The answer is not objective, but based on review of trends in revenues, expenditures, enrollment, and other financial/management metrics. Changes are addressed annually in the Management Discussion and Analysis that accompanies the financial statement. Based on total E & G expenditures for the USC system in the 2008/2009 fiscal year, the University could cover 3 months of E & G expenditures. Total E & G unrestricted net assets is approximately 10% of the total system budget.

USC Columbia’s Education & General unrestricted net assets at June 30, 2009 were $157,196,371. Commitments of these funds are:

- $33.8M OneCarolina Project
- $1.2M Faculty Excellence Initiative
- $43.2M Academic Units - General Operating-includes faculty hiring & start-up costs
- $19.0M Academic Units - Derived from Grants
- $30.1M Service Units and General Fund obligations
- $8.8M General Fund Unallocated
- $16.3M Technology
- $2.9M Student Activities
- $0.4M Scholarships
- $1.5M Designated funds derived primarily from vending commissions
- $157.2M Total E & G Unrestricted Net Assets

USC Columbia’s total unrestricted net assets at June 30, 2009, including auxiliary enterprises, quasi-endowments, and unexpended plant funds were $239,570,819. Commitments of these funds are:

- **Auxiliary Enterprises**
  - $8.8M Student Health Center
  - $10.7M Housing
  - $2.5M Bookstore
  - $1.1M Vending and Concessions
  - $9.4M Athletics
  - $4.0M Food Service
  - $2.5M Parking
  - $3.1M Other
  - $42.1M Total Auxiliary Enterprises

- $27.4M Quasi-Endowments
- $12.9M Unexpended Plant Funds
- $157.2M Total E & G detailed above

**$239.6M Total Unrestricted Net Assets – USC Columbia at June 30, 2009**

Detail of all unrestricted net assets at June 30, 2010 will be documented following the annual audit of fiscal year activity and preparation of the University’s financial statement.