The Large Public University

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CFO Perspectives

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Public institutions of higher education often have massive enrollments, large campuses, and a wide expanse of programs. Because of their public purpose—to provide the primary access to higher education for most students—these institutions produce the majority of degrees and play an essential role in economic development and research initiatives.

Given their size and mission, public universities typically dominate the student market in their states. Because of state support, their tuition rates usually fall below tuition at private colleges or universities. As a result, during difficult economic times, many students who would have enrolled in private colleges turn to state universities instead. This greatly increases enrollment at the same time that states are losing tax revenue and thus reducing their support for higher education.

For example, according to *The Chronicle of Higher Education*, states' appropriations for public institutions reportedly declined 3.5 percent for 2008-09; the difference had to be made up from other sources, especially tuition and fees. Many states give public institutions the discretion to increase tuition rates to make up for shortfalls in state revenue appropriations. State regulators, however, may also restrict the size of tuition increases, especially for undergraduate, in-state students. In Florida, for example, a public institution may increase undergraduate, in-state tuition by as much as 15 percent, with 30 percent of the increase beyond a legislatively determined amount assigned to need-based financial aid.

Fundraising for endowments represents another source of recurring revenues. Before the 1980s, fundraising at state institutions was confined mainly to raising money for athletic teams and other special university projects and programs. These efforts led to some of the largest and richest athletic programs at public universities. As revenues have tightened during recessions over the past three decades, however, fundraising for general expenses has become a larger part of the revenue package at state institutions.

The 10 largest public universities in the United States have enrollments that exceed 40,000—and three of them are located in Florida. In addition, Florida is home to two of the three largest state/community colleges, each with more than 50,000 students. For a state university in Florida, the main revenue sources are:

State Appropriations for Student Enrollments. Enrollment revenue is determined by a formula approved by the state legislature and allocated by the department overseeing higher education at public colleges and universities. The formula, which varies by state, may be based on multiple variables or factors, including student headcounts, full-time equivalents (FTEs), full-time/part-time mix, credit hours, level of instruction (lower, upper, and graduate), number of campuses, and program mix.

Often, funding for each factor is based upon historical institutional or system average expenditure patterns and, therefore, not perfectly related to actual costs. As an example, Table I shows state appropriations for enrollments at Florida International University (FIU) for FY2010-11. FIU has more than 42,000 students; an operating budget of approximately $600 million, excluding student financial aid; and $816 million in net assets.

Table I

**FY 2010–11 Enrollment Funding—
Florida International University**

Level	Appropriation per FTE
Lower Level	$8,738
Upper Level	$13,485
Graduate I	$24,471
Graduate II	$35,271
Medicine	$55,000

At first glance, Table I seems to indicate that a comparable university's financial interests would be best served by maximizing graduate and medical enrollments. The net revenue, however, is what really matters. So the enrollment incentives for a Florida university would depend on which level generates the largest net revenue for that institution. Even if medicine did produce large returns on its enrollment appropriations, the potential scale of enrollments may not be large enough to support the institution's mission to provide undergraduate education.

Student Tuition and Fees. Tuition paid by students represents a significant source of operating revenues. In addition, fees for athletics, health, student facilities, scholarships, student activities, and parking are necessary to fund essential functions and services at public institutions. Generally, restrictions on the use of state appropriations or student tuition do not allow their use to support programs and services outside of educational programs. Consequently, fees are used to support programs and activities that enhance student life at the institution.

Declining state appropriations often trigger increases in tuition and fees subject to limits set by the state. The increases may also occur when the state funding formula lags enrollment growth. This can happen if the formula is based on prior year enrollments or is fixed in the fall and ignores subsequent enrollment changes—either increases or decreases—in the spring.

Unprecedented reductions in state appropriations over the past decade have often led to tuition increases to offset the negative impacts of reduced state assistance; this is particularly true for undergraduate, in-state students, who historically have received the greatest amount of state support. Until recently, state legislators have kept tuition levels low for resident undergraduates, even during times of double-digit tuition increases for out-of-state students and graduate students, in an effort to balance student access with a high-quality educational program.

Sometimes, public boards of trustees will propose large increases in tuition right before the legislative session ends; their intention is to pressure legislators to increase appropriations. If legislators are reluctant to increase state appropriations, they may bear the wrath of parents who see the state as failing in its duty to provide a low-cost college education for their children. From 2008 to 2010, however, legislators had little choice but to lower appropriation levels because state tax revenues had fallen so far.

Enrollment Growth

Most public institutions would describe enrollment as a double-edged sword. On one side, it can yield higher state revenues based on state enrollment formula funding, student tuition, and student fees. On the other side, it represents higher costs that may not be fully compensated by the increase in state and tuition revenue increases.

Enrollment is also tricky for the state because the official count date may not completely capture all the students who drop out early or enroll after the official count occurs. Severe economic downturns during the fall semester, for example, may encourage some students in private or out-of-state public colleges and universities to switch to in-state public institutions at mid-year. This would increase the yield rate—the percentage of accepted students who actually enroll—beyond historical or anticipated levels. But the college or university may not receive the revenue it needs if mid-year enrollment growth boosts costs due to greater than projected enrollments or over-enrollments.

Public institutions may have a strong incentive to encourage enrollment growth when the state reduces its allocations based upon the enrollment growth funding formula. The objective is to find students who pay the full cost of their education, giving the business office sufficient cash to operate. This condition makes out-of-state students, in terms of the tuition revenue they generate, more valuable than in-state students. Institutions must evaluate the increase in recruitment costs associated with attracting out-of-state students with the increase in tuition revenue generated. But, if the incremental revenues are positive, the incentive to enroll more out-of-state students could be large, especially at the undergraduate level where assistantships are not as common as for graduate students.

Enrollment also grows during severe economic downturns, as high school graduates and transfer students from middle-income families choose lower-cost public colleges and universities. Yet, while enrollment growth during an economic downturn spikes enrollment, it does not contribute sufficient income because financially embattled states lower their tuition support.

While the temptation to increase tuition is great when appropriations have been reduced or do not keep pace with cost increases, public institutions must consider any increase's impact on student demand and access. This is especially true for institutions that serve large non-traditional populations, such as students who work full- or part-time to pay for their education. Significant increases in tuition over time will mean that many working students will stop out, drop out, or reduce the number of courses they can afford to take each semester.

Ensuring sufficient need-based financial aid is available to the students with the greatest need will help mitigate the negative impact of large tuition increases. Certainly, balancing the need for tuition and fee revenues to meet the costs of providing educational opportunities against the financial means of students is one of a chief financial officer's most difficult responsibilities.

Contracts and Grants. Most revenue from contracts and grants awarded by federal, state, and local government agencies and from private agencies and foundations goes toward funding direct costs. Direct costs include compensation, travel, materials, supplies, equipment, rentals, and other non-compensation expenses directly attributed to the particular research project or program. Some contracts and grants also provide for capital funding—generally for equipment or facilities that can be used only for the specific project.

The financial importance of these types of revenue, however, lies in their funding of indirect costs. Indirect costs help cover administrative and other costs expended for general operations of the college or university that support the research grant. Depending upon a particular funding source's regulations, indirect costs may encompass student services, academic administration, institutional administration, or plant expenses—such as utilities expended in support of the sponsored research program. Indirect cost rates are negotiated for federal grants using costs calculated by the business and research offices, which then yield a rate related to direct costs.

The average indirect cost recovery rate, calculated using total sponsored research expenditures and total indirect costs recovered, will depend upon the types and mix of projects awarded. More federal grant awards will yield higher indirect cost rates. For Florida International University, as an example, the average indirect cost rate is approximately 16 percent.

Table II illustrates indirect cost rates at a large public university in Florida. Federal grants provided the most attractive rate, with some foundations offering reasonable indirect rates as well. As Table II shows, however, not all foundations provide indirect cost reimbursements, and the State of Florida's reimbursement rate is rather low. Many federal, state, foundation, and private grant awards do not provide for either full or partial recovery of indirect costs.

Table II

Indirect Cost Rates

Federal Indirect Cost Rate	44%
State of Florida Indirect Cost Rate	5%
Foundation Indirect Cost Rate	0 – 25%
Private Indirect Cost Rate	Negotiated

Faculty members, who write most contracts and grants, are primarily interested in how the grant can support their research priorities and in grant incentives that allow them to reduce their instructional load. These incentives include trade-offs in reduced teaching loads, travel funds, equipment to support the research project, and the ability to hire assistants who will help with experiments or other aspects of the research. Faculty understand that most public institutions are unable to fund important research projects from their educational budgets; they also understand that indirect cost reimbursement is an incentive for the college or university to support their grant applications and work.

Revenue from contracts and grants, on average, represented about 19 percent of the total revenues for public institutions in 2008, as noted in *Finances of Colleges and Universities, 2008 Fiscal Year*, published by *The Chronicle of Higher Education*. Although most of these revenues covered the sponsored research project's direct expenses, a large portion of the revenues supported indirect expenses for the operation of a public institution, including the funds for sponsored research program administration. In addition, nearly 1.2 percent of the contract and grant revenues were spent on capital projects.

Facilitating Outside Funding

A significant loss in contract and grant funding will reduce funding for general operations, the hiring of quality research faculty, and maintenance of the institution's academic and research reputation. To ensure a smooth flow of contract and grant funds into the institution, a CFO must set up policies and procedures, in consort with grant rules, for:

- Using grant funds.
- Defining what the university includes in its indirect cost rates.
- Keeping records of what is included in indirect costs.
- Establishing records to account for the use of direct costs.
- Filing accurate reports on contracts and grants.
- Conducting internal audits of contract and grant use, or arranging for external auditors to conduct audits that go beyond the normal grant report audits required by the government or private funding agencies.
- Giving regular reports on receipts and use of funds to the president and the board of trustees.

A 19 percent contribution to revenue from contracts and grants is not insignificant for a college or university. Programs that encourage and support faculty and professional staff to apply for sponsored research projects will help ensure these revenues continue to flow into the institution.

State Appropriations for Special Projects. States do not necessarily limit their support to enrollment appropriations. They also provide public institutions with funds for special projects and pass-through support to pay for specific costs subject to large inflationary increases.

Special funding can fund current operations, a project important to the state's or the institution's strategic priorities, or a capital project. Current operational funding, for example, may support remedial skills, language development, or instructional or research programs believed to enhance the state's economic potential.

Capital projects that would need state support may include instructional buildings, libraries, research facilities, or student service centers. Reasons for a large public institution to require special funding include:

- The cost of providing buildings and infrastructure is so large.
- The state limits the institution's ability to issue debt for a capital project.
- The capital project does not generate sufficient revenue to cover the cost of debt service.

The state may also provide pass-through funding to cover increases in certain expenses that are outside the institution's control, such as utilities, plant operations and maintenance, insurance, or employee benefits. Pass-through funding is often episodic and lasts only for a short period when large inflationary spikes occur or a particular problem arises. For example, after the tragic shootings at Virginia Tech in 2007, many states increased funding specifically to support improvements in campus safety and security programs, emergency management initiatives, and enhanced security alert systems.

Auxiliary Operations. Typically, auxiliary enterprises include food services, housing, traffic and parking, and the bookstore. Large public institutions also may use auxiliary enterprises to run these services: printing, telecommunications, postal services, student health center, intercollegiate athletics, continuing education programs, and the student center.

Auxiliary operations—which are expected to cover their costs and contribute net revenue to the institution—generate approximately 8 percent of a public institution's revenue. These self-supporting operations are funded by local fees paid by students—for student health services, for example—in addition to the specific revenues they generate. As state appropriations decline, public institutions are turning more to a privatized, self-funding approach to operate important services; this approach charges users a fee for the particular services they receive.

It is sometimes difficult for an institution to closely watch the financial and service performance of all its auxiliaries. Many public institutions have hired outside contractors and vendors to run auxiliary enterprises; they aim to improve service levels or reduce costs, while freeing the institution to focus on its core competencies. Once a contract is negotiated, the vendor—not the college or university—will incur any losses. Of course, vendors that cannot realistically produce a profit or provide the same level of service as originally defined will cease to provide the services altogether.

Auxiliaries require that CFOs do more than check performance at the end of the fiscal year. The institution should have systems in place to ensure strong management, if it runs the auxiliary, or strong oversight, if an outside vendor runs the auxiliary. Whether internally managed or outsourced, auxiliaries should achieve their financial and service performance goals by:

- Producing positive net income.
- Having operational management that delivers marketable and reasonably priced services to students, faculty, and staff.
- Paying an overhead fee to cover the costs of support services provided by the institution, such as administrative support, facilities, and utilities.

Other Revenue Sources. State colleges and universities also have access to funds from foundations, fees for health care, concession revenues from vending operations, and investment earnings. The foundations and special funding entities generate revenue and sometimes expend funds to support the institution's mission. At Florida International University (FIU), for example, several independent, direct-support organizations funnel money into the institution. These include two foundations (Florida International University Foundation and Florida International University Research Foundation), a special funding entity for athletics (Florida International University Athletic Finance Corporation), and a special funding entity for health services (Florida International University Health Care Network).

CFOs must closely monitor funds from direct-support organizations to ensure they are used according to policies and procedures established by the business office and the organization itself. These policies and procedures can help an external funding group, such as FIU's Athletic Finance Corporation, conform to stringent regulations established by accrediting organizations, such as the National Collegiate Athletic Association (NCAA).

Student government fees represent a unique revenue source. The university collects the funds so that students can manage their own affairs regarding the distribution of funds to organizations and events that benefit the student body in general. Student government associations, while they have the authority to determine how funds are spent, must ensure that funds are distributed and used according to accepted accounting procedures, state requirements, and university policy. As a result, funds received and used by the student government are subject to the same auditing requirements as the rest of the institution.

At Florida International University, for example, student government has responsibility for approximately $11 million of student fees. The CFO can provide training for student government leaders so they understand and can carry out their responsibility to account for and report on how their funds are expended to benefit their constituents—the students at the university.

Capital Funding

When funding capital projects, a public institution has three options: debt, state appropriations or grants, and money from institutionally related foundations (discussed above).

Debt is used mainly for projects, such as residence halls and parking facilities, that generate sufficient revenue to pay the cost of operating, including debt service. Many public colleges and universities have felt stress from their debt loads, especially when they use tuition to bond capital projects, because of decreases in state funding. Because public institutions price their tuition well below private institutions, they are able to raise tuition to recoup the loss of state revenue without adversely affecting their prospects for enrolling students.

State appropriations for capital projects may come from special project funding approved by the legislature. Usually, state-funded institutions compete fiercely for the small pot of money that a legislature makes available for capital projects.

How State Appropriations Are Expended

In most states, the legislature defines how public institutions must expend state appropriations. For example, Florida directs that appropriations are to be expended for instruction, research, technology, libraries, student services, branch campus operations, and university support. Most public institutions blend the state appropriations with other revenues into a comprehensive operating budget. This affirms the institution's status as a public entity, all of whose operational aspects come under the scrutiny of the legislature and the executive branch.

Special project and pass-through funding require different accounting procedures than appropriations for general operating expenses. In these cases, the CFO needs to carefully track and report all expenditures to assure the legislature and executive agencies that expenditures were made for the intended purposes.

Some heavily endowed public institutions treat state appropriations like a restricted grant and assign the funds to specific expenditures—especially when state appropriations decline. The CFO then tracks appropriation flows into the institution and how each dollar is spent, with financial records and reports mirroring financial reporting for grants. Capital goods funded by state appropriation will be tagged and depreciated with reference to the specific appropriation or period of the appropriations.

By treating state appropriations like restricted grants, public institutions can:

- Avoid commingling of funds.
- Limit the oversight of legislative or executive departments.
- Sustain the proposition that the institution, though public, can act as a private institution. (This gives institutional leaders greater independence when making decisions.)

Grants typically come from businesses that are funding research facilities or foundations, if they have active and wealthy donors. Some donors, however, may direct their monies for capital projects that do not necessarily fit into the institutional strategic plan. It is essential that the CFO work with foundation leadership to ensure that fundraising programs, including capital projects, remain linked to the institution's strategic priorities.

Whatever the funding model, CFOs play a major role during the development and financing of capital projects. They often must convince bankers, bondholders, legislators, foundations, and/or grantors of the need for and value of the capital project. They also must develop forecasts and plans for funding the project, oversee the preparation of legal documents for projects using debt, account for the expenditures on the project, provide for payment on debt service, and manage any covenants associated with the debt.

Politics of Balancing the Budget

Presidents, chief academic officers, and CFOs of large public institutions must be adept at the legislative process to ensure their institution does not lose out on funding requests for important projects in favor of their public competitors, which include community colleges, state colleges, other public services, and major infrastructure projects in the state. When state funding contracts, the competition for public funding becomes especially intense.

Lobbying legislators and relevant members of the executive branch to support the institution's proposals—whether through increases in state appropriations, tuition, or fee flexibility or through funding for special projects—requires more than the ability to make a PowerPoint presentation. At a minimum, these political efforts require the institution's senior leadership, including the CFO, to:

- Understand the nuances of state funding equations and the governing and legislative processes.
- Identify interest groups within the institution's community that can work with the executive branch and the legislature to build winning coalitions.
- Lobby the case to legislators and members of the executive branch.

- Seek support from local legislators—those representing the districts where the institution's campuses are located—by informing them of how valuable the program or initiative is to students and the local economy.
- Convince alumni legislators and members of the executive branch of a project's or appropriation's value to their alma mater.
- Become trusted and significant intermediaries with legislative and executive agencies; legislators and heads of executive agencies must know that the information they receive is valid, not skewed to distort the facts.

It falls to the CFO to coordinate a never-ending balancing act among increasing costs of education, growing enrollments, declining revenue appropriations, limits set by the state on subsidies, tuition subsidies from the state, discretionary spending, special programs initiated by the state to alleviate unexpected cost increases, and the requirements of special programs introduced by the governing board of a state-wide system of higher education. In addition, the CFO must factor in net revenue from auxiliaries, contracts, grants, student fees, and foundations or other direct support organizations—while remaining responsive to changes in the economy, state and system-wide priorities, and academic and support program needs.

Clearly, the CFO job at a large public university is not for the faint-hearted. All of the CFO's work is scrutinized by auditors, state executive agencies, state legislators, federal regulators, accreditation associations, and third parties, such as the NCAA. Every organization that provides funds for the institution needs to be comforted and assured that their money is spent as intended and accounted for according to strict regulations and basic accounting rules.

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Take Away Points

- Understand the processes and regulatory requirements for state funding.
- Establish rigorous accounting policies and procedures for all funds and expenditures.
- Set up financial rules to guide relationships with institutional foundations.
- Become adept at working with legislators and executive departments to ensure adequate funding of enrollment formulas, special projects, and pass-through funds.
- Keep an alert eye on new processes to improve the efficiency of the financial office and college operations.
- Develop close relationships with key institutional administrators who have budgetary responsibility or provide information critical to the budget.