State Auditor's Office
John Keel, CPA
State Auditor

An Audit Report on

The Reasonableness and Results of Tuition Increases Implemented by Four Higher Education Institutions in the 2004-2005 Biennium

September 2, 2005

Members of the Legislative Audit Committee:

Reasonableness of tuition increases at four public higher education institutions

Higher education institutions' unique accounting methods restrict fiscal audit analysis of tuition increases at four of the State's largest higher education institutions. However, when assessed by other types of criteria such as peer group comparisons, tuition increases at these four institutions appear reasonable.

Factors unique to higher education accounting restricted the State Auditor's Office's ability to draw a conclusion, based on fiscal audit analysis alone, regarding the need for tuition increases or for the amount of the increases implemented during the 2004–2005 biennium at the four institutions we audited: The University of Texas at Austin, Texas A&M University, Texas Tech University, and the University of Houston. The following points provide further detail:

- Although we could not determine the reasonableness of tuition increases using a fiscal audit analysis, we identified other criteria against which to evaluate the reasonableness of tuition increases such as accreditation standards from the Southern Association of Colleges and Schools, compliance with statutory requirements, and comparisons with each institution's national peer group. When institutions' performance is assessed using these types of criteria, tuition increases appear reasonable. Part 3 of the *Analysis of Tuition Increases* attached to this letter contains additional information regarding these criteria.

- Institutions receive revenue from a variety of public, private, and local sources, and they have—under higher education standard accounting principles—the flexibility to combine and make transfers within and among accounts and funds that do not have legal, grantor, or donor restrictions. This precludes a fiscal audit analysis to determine the need for additional funding in any specific area (such as faculty salaries) at a point in time.

- Universities use various criteria—financial analysis, institutional priorities, and other information, such as peer comparisons—to develop budgets and make trade-offs between equally important, competing

Background Information

House Bill 3015 (78th Legislature, Regular Session) amended the Texas Education Code to permit Texas higher education institutions to charge the amount of designated tuition they consider necessary.

Percentage increases in tuition and mandatory fees (adjusted for inflation) during the 2004-2005 biennium at the four audited institutions were as follows:

- The University of Texas at Austin: 38 percent
- Texas A&M University: 20 percent
- Texas Tech University: 44 percent
- University of Houston: 49 percent

Increases in tuition at these institutions generated \$176.2 million in additional revenue from spring and fall 2004 and spring 2005 (excluding summer 2004 and 2005). The net amount of new revenue from these three semesters available for general operating expenses after deducting the required financial aid set-aside was \$133.2 million. Some institutions set aside more than the minimum required, such as the 29 percent the University of Texas at Austin set aside.

Net of the student financial aid set-aside, each institution had the following amounts of revenue for general operating expenses from increased tuition in 2004 and 2005 (not including summer tuition for 2004 or 2005):

- The University of Texas at Austin: \$60.4 million
- Texas A&M University: \$28.9 million
- Texas Tech University: \$17.5 million
- University of Houston: \$26.4 million

SAO Report No. 06-001

needs. This information does not provide a basis for a fiscal audit analysis of need for tuition increases.

- Significant differences in the ways that higher education institutions classify revenues and expenditures preclude the development of meaningful comparisons across institutions. For example, there are no standard benchmarks for ratios in areas such as instruction expenditures per student or administrative expenditures to total expenditures.

Recommendation

The above factors are common to higher education fiscal administration; however, the information institutions report to decision makers, students, families, and the general public could be more useful if it were presented in a more consistent manner. The Legislature may consider requiring institutions to develop and implement more detailed standards for the classification of reported revenues and expenditures. Such standards could result in institutions' and the Texas Higher Education Coordinating Board's (Coordinating Board) producing the detailed information necessary to provide reports that are more accessible and comparable across the State's institutions of higher education. Efforts are already underway to address consistency in financial reporting.

Uses of Increased Tuition Revenue

Only one audited institution—Texas Tech University—established separate budget, revenue, and expenditure accounts that enabled us to identify the specific expenditures that were made with the revenue from increased tuition. Although the University of Houston did not establish separate accounts, it maintained records that allowed us to verify that the increased tuition revenue was spent as planned.

The two other audited institutions budgeted and, in most cases, spent the amount of funds they intended to spend in the areas for which they stated that tuition increases were necessary. However, as discussed above, these institutions' use of multiple sources of revenue for these expenditures prevented us from determining their actual expenditures from increased tuition revenue, or whether revenue from increased tuition was the source of their actual expenditures in the areas for which they stated that increases in tuition were necessary. Part 2 of the *Analysis of Tuition Increases* attached to this letter provides additional details on the audited institutions' planned, budgeted, and actual expenditures.

Recommendation

To hold institutions accountable for the receipt and expenditures of incremental tuition revenue, the Legislature would need to require public institutions to account separately for the uses of that revenue. An alternative approach would be for the Legislature to consider using outcome measures compared to the stated reasons for increases in tuition as a way to ensure accountability for such increases.

Distribution of Student Financial Aid from Funds Set Aside from Increased Tuition Revenue

Texas Tech University was the only audited institution that performed the statutorily required calculation to identify students to whom priority must be given in awarding student financial aid from the funds set aside from increased tuition revenue. A statewide survey of four-year institutions of higher education that raised tuition above $46 per semester credit hour indicated that no other institution in the state performed this calculation.

As specified in Texas Education Code, Section 56.012(b), "priority shall be given to students who meet the coordinating board definition of financial need and whose cost for tuition and required fees is not met through other non-loan financial assistance." The effect of giving priority in awarding financial aid to students identified by the called-for calculation would have been to partially or fully offset the increased cost of tuition and fees for students with less than the greatest amount of financial need. Students with the greatest amount of financial need would have their cost of tuition and fees already covered by non-loan (grant) aid. Identifying students to whom priority must be given according to statute requires a unique calculation that is separate from the existing financial aid award calculation process.

As part of this audit, we conducted a retrospective priority analysis based on our interpretation of the Texas Education Code's definition of unmet need. The results of that analysis indicated that, at the audited institutions over spring and fall 2004 and spring 2005:

- 62,196 awards could have been but were not awarded to students who met the statutory requirements for priority in awards. Because the Texas Education Code does not specify the amounts of financial aid to be awarded to eligible students, it is not possible to determine how much in set-aside funds these students would have received. It is important to note that the audited institutions appear to have acted in good faith in attempting to meet their understanding of student need in awarding financial aid. In addition, some institutions set aside significantly more than they were required to set aside.

- 18,244 awards totaling $11,423,881 from set-aside funds were made to students who did not qualify for priority in the award of set-aside funds according to the statutory definition of unmet need. Most students who received awards from set-aside funds had financial need according to the Coordinating Board's and the federal definition.

Part 4 of the *Analysis of Tuition Increases* attached to this letter contains additional information regarding the student financial aid prioritization requirement.

There are challenges to implementing the student financial aid prioritization requirements of the Texas Education Code, as follows:

- Institutions would not be able to perform the precise calculation to identify students who qualify for prioritization until all non-loan aid had been awarded, which would require a retrospective analysis to comply with the statute. Texas Tech University was able to perform the statutorily required calculation only by estimating the average tuition and fees cost for the year and identifying eligible students early in the semester, before all non-loan aid was known. Even this process, however, resulted in awards' being given to some students who later became ineligible for their awards as a result of receiving additional non-loan aid.

- When financial aid set-aside funds were being awarded at the beginning of each semester, institutions had estimates of the total amount of tuition revenue that would be available for that aid. If more revenue was taken in for the set-aside, the balance was carried forward to the next semester instead of being awarded in the semester in which the revenue was taken in.

- The amounts of financial aid awarded from the set-aside funds varied from institution to institution. The Texas Education Code specifies the different types of aid that could be awarded with tuition set-aside funds, but it does not specify the amount to be awarded each student.
- The Texas Education Code does not define precisely what giving priority to students with unmet need means. As a result, institutions interpreted this differently. One institution reported that this meant considering those students but not necessarily awarding them set-aside funds.
- The Texas Education Code does not prohibit awarding tuition set-aside funds to students who do not have unmet need.

Recommendation

To address these challenges, the Legislature should consider (1) capturing more precisely legislative intent regarding the distribution of student financial aid from the required set-aside funds and (2) providing guidance on implementation of that intent.

Review of Fund Account Balances to Identify Funds to Mitigate the Need for Tuition Increases

Because institutions have the flexibility to combine and make transfers within and among funds, we could not identify accounts with surplus funds that could be used to mitigate tuition increases. However, our analysis identified certain account balances that the institutions agreed had surplus funds that would be used to support future operating budgets, thus potentially mitigating future tuition increases in the short term. It is important to note, however, that any funds that might have been used to defer or mitigate tuition increases would be available only for a limited time (for example, for one or two semesters) and would not necessarily mitigate tuition increases in the long term. Part 5 of the *Analysis of Tuition Increases* attached to this letter provides additional details on our analysis of audited institutions' fund balances.

The University of Texas at Austin is implementing comprehensive policies and procedures for the routine review of account balances in the three types of funds we audited: unexpended plant funds, endowments, and service departments, which are part of designated funds at the university. The other three audited institutions have some policies in place for reviewing some, but not all, of these types of account balances, including service department accounts in the educational and general fund as applicable.

Recommendation

To ensure that institutions consider the results of their fund balance reviews in making decisions regarding tuition rates, the Legislature would need to require them to conduct and document their reviews of fund balances and certify their inclusion of these reviews in their tuition planning processes.

The *Analysis of Tuition Increases* attached to this letter contains additional details regarding the institutions we audited and their increases in tuition, as well as the audited institutions' responses to this audit report.

We appreciate the audited institutions' cooperation during our audit. If you have any questions, please contact Carol Smith, Assistant State Auditor, or me at (512) 936-9500.

Sincerely,

John Keel, CPA
State Auditor

cc: The University of Texas at Austin
- Members of the University of Texas System Board of Regents
- Mr. Mark G. Yudof, Chancellor, The University of Texas System
- Dr. Larry R. Faulkner, President, The University of Texas at Austin

Texas A&M University
- Members of the Texas A&M University System Board of Regents
- Dr. Robert D. McTeer, Chancellor, Texas A&M University System
- Dr. Robert M. Gates, President, Texas A&M University

Texas Tech University
- Members of the Texas Tech University System Board of Regents
- Dr. David R. Smith, Chancellor, Texas Tech University System
- Dr. Jon Whitmore, President, Texas Tech University

University of Houston
- Members of the University of Houston System Board of Regents
- Dr. G. Jay Gogue, Chancellor of the University of Houston System and President of the University of Houston

Analysis of Tuition Increases

Contents

Part 1: Background Information

After the 78th Legislature gave governing boards of state higher education institutions the authority to charge students designated tuition at a rate considered necessary for the effective operation of the institution, the four institutions we audited implemented increases in designated tuition that increased the total average tuition by 33 to 54 percent over the 2004–2005 biennium (adjusted for inflation). These institutions—The University of Texas at Austin, Texas A&M University, Texas Tech University, and the University of Houston—are four of the five largest public higher education institutions in the state.

During the same period, these four institutions raised mandatory student fees by 7 percent to 81 percent. As Table 1 shows, the *combined* increase in tuition and mandatory fees ranged from 20 percent to 49 percent.

Table 1

Increases in Designated Tuition, Mandatory Fees, and Cost of Attendance Before Student Financial Aid at Four Higher Education Institutions (Adjusted for inflation - constant 2004 dollars)

Institution	Percentage Increase in Tuition over the 2004-2005 Biennium	Percentage Increase in Mandatory Fees over the 2004-2005 Biennium	Percentage Increase in Tuition and Mandatory Fees over the 2004-2005 Biennium	Percentage Increase in Cost of Attendance from the 2002-2003 Biennium to the 2004-2005 Biennium [a]	Five-Year Percentage Increase in Cost of Attendance 2001-2005	Average Annual Increase in Cost of Attendance 2001-2005
The University of Texas at Austin	54%	7%	38%	7%	19%	3.8%
Texas A&M University	33%	3%	20%	23%	32%	6.4%
Texas Tech University	34%	65%	44%	15%	23%	4.6%
University of Houston	40%	81%	49%	33%	43%	8.6%

[a] Cost of attendance is for resident students living on campus and includes tuition and fees, books, supplies, transportation, miscellaneous personal expenses, room and board, and student loan fees.

Sources: Tuition and mandatory fees figures are from each institution's common data sets posted on their Web sites. The cost of attendance was provided by each institution's student financial aid office, except for Texas A&M University, which posted all five academic years on its student financial aid Web site. Adjustments in cost for inflation were based on the Consumer Price Index from the U.S. Department of Labor Statistics.

However, as Table 1 also shows, the total cost of attendance at these four institutions increased by 7 percent to 33 percent during the biennium before taking student financial aid into account. Over the *five-year period* from 2001 to 2005, the increase in the cost of attendance at the four institutions, without considering student financial aid, ranged from 19 percent to 43 percent. The average *annual* increase in cost of attendance over the five-year period ranged from 3.8 percent to 8.6 percent. Over the same five-year period, the Texas median family income (for a family of four) increased from $56,108 to $56,278 (in constant 2004 dollars), an increase of only 0.3 percent over five years and an average annual increase of only 0.06 percent.

Although the amount of federal, state, and institutional financial aid awarded by each of the four audited institutions significantly reduced the average cost of attendance for students with financial need, further analysis would be necessary to determine how the burden of the increases in tuition was distributed across all income groups. Because most students from low-income families would have the total cost of tuition and fees covered by their non-loan financial aid, the effect of giving priority in awards to students with unmet need as defined by the Texas Education Code would be to offset some of the increased tuition cost for students who did not qualify for enough non-loan aid (grants) to cover the cost of tuition and fees.

Tuition increases at the four audited institutions generated $176.2 million in additional revenue from spring and fall 2004 and spring 2005 to date, $133.2 million of which was available for general operating expenses.

Table 2 presents enrollments and operating expenses for the four audited institutions and their tuition and fees, cost of attendance, and increased revenues from increased designated tuition from spring and fall 2004 and spring 2005 in current dollars. As this table shows, increases in tuition at these institutions have generated $176.2 million in additional revenue to date. After setting aside at least the required portion of this revenue for student financial aid, the four institutions had $133.2 million in additional revenue for general operating expenses over the biennium.

Table 2

Enrollments, Operating Expenses, Tuition and Fees, Cost of Attendance, and Increased Tuition Revenues at Four Higher Education Institutions						
Institution	**Total Enrollment (for all Student Categories) in Fall 2004 (Academic Year 2004-2005)**	**Total Operating Expenses FY 2004 [a]**	**Average Tuition and Mandatory Fees in Academic Year 2004-2005**	**Average Cost of Attendance in Academic Year 2004-2005 [b]**	**Total Revenue from Increased Tuition for Spring 2004 and Fall and Spring 2004-2005**	
The University of Texas at Austin	50,377	$1.4 billion	$5,734	$17,488	Spring 2004:	$16.1 million
					Fall 2004 and Spring 2005:	68.5 million
					Total:	$84.6 million
Texas A&M University	44,435	$842 million [c]	$5,955	$16,167	Spring 2004:	$ 4.8 million
					Fall 2004 and Spring 2005	29.8 million
					Total:	$34.6 million
Texas Tech University	28,325	$426 million	$5,848	$16,729	Spring 2004:	$ 3.2 million
					Fall 2004 and Spring 2005 (as of March 31, 2005)	19.9 million
					Total:	$23.1 million
University of Houston	35,180	$500 million	$4,973	$17,882	Spring 2004:	$ 7.1 million
					Fall 2004 and Spring 2005:	26.8 million
					Total:	$33.9 million
					Total Revenue	**$176.2 million**
					Student Financial Aid Set-Aside	**$43.0 million**
					Net Increased Revenue for General Operating Expenses	**$133.2 million**

[a] Total operating expenditures include instruction, research, public service, academic support, student services, institutional support, operations and maintenance of plant, scholarships and fellowships, auxiliary enterprises, and depreciation and amortization.

[b] Cost of attendance is for resident undergraduate students living on campus and includes tuition and fees, books, supplies, transportation, miscellaneous personal expenses, room and board, and student loan fees.

[c] Total Texas A&M University operating expenditures include only research expenditures accounted for by Texas A&M University, for a total of $61,993,044, as Texas A&M reported in its fiscal year 2004 annual financial reports. They do not include research expenditures by Texas A&M University's related service agencies, such as the Texas Cooperative Extension. When reporting research expenditures to the Texas Higher Education Coordinating Board, Texas A&M University includes expenditures made by the service agencies, which results in the total research expenditure figure of $390.7 million shown in Table 17.

Sources: (1) Enrollment numbers are from each institution's statistical handbook or fact book published on its Web site; (2) operating expenses are from each institution's annual financial report; (3) Tuition and mandatory fees are from each institution's common data sets posted on their Web sites; (4) Cost of attendance was provided by each university's student financial aid office, except for Texas A&M, which posted all costs for five academic years on its Web site. The amounts of increased tuition revenue were provided by each institution and verified by the State Auditor's Office.

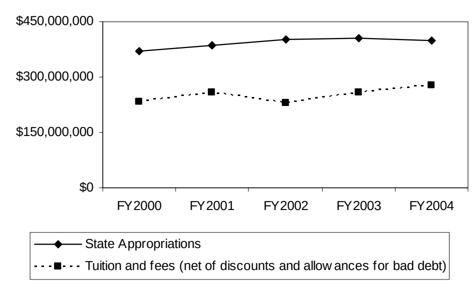
Nationwide, the portion of higher education revenues contributed by state appropriations has been decreasing, but the prices that institutions pay for goods and services have been increasing.

The portion of total higher education revenues contributed by state appropriations has declined steadily over the past 20 years nationwide, although appropriations per full-time student equivalent (FTSE) have tended to rise and fall cyclically in response to downturns and upturns in the economy. Nationwide during the past twenty years, tuition and fees have risen as state support for higher education has decreased. In many cases, however, universities make the decision to increase tuition and fees in a context of identifying and implementing other options for making up budget shortfalls, such as cost savings, staff reductions, reallocations, and use of reserves. Figure 1 shows the trend in state appropriations and the trend in average net tuition and fees for each of the four audited institutions, using figures from each institution's annual financial reports for fiscal year 2000 through fiscal year 2004.

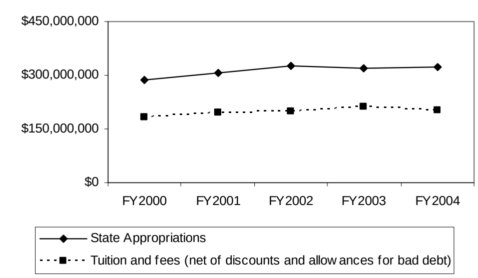
Figure 1

Audited Institutions' State Appropriations and Tuition and Fees [a]
(Net of Discounts and Allowances for Bad Debt)
Fiscal Years 2000-2004

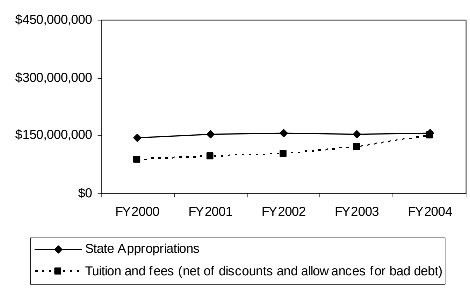
The University of Texas at Austin



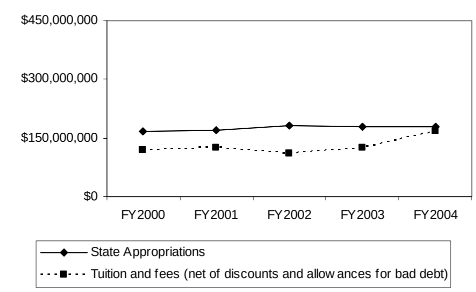
Texas A&M University [b]



Texas Tech University



University of Houston



[a] State appropriations include appropriations from General Revenue and excellence funding. Excellence funding for the University of Texas at Austin and Texas A&M University is distributed from funds appropriated to the Available University Fund (AUF) from the state's Permanent University Fund (PUF), the largest public higher education endowment in the country. General Revenue funding for Texas Tech University and the University of Houston includes funds appropriated from the Higher Education Fund (HEF), which is primarily used for capital infrastructure expenditures.

[b] Texas A&M University's discounts and allowances for bad debt increased in fiscal year 2004.

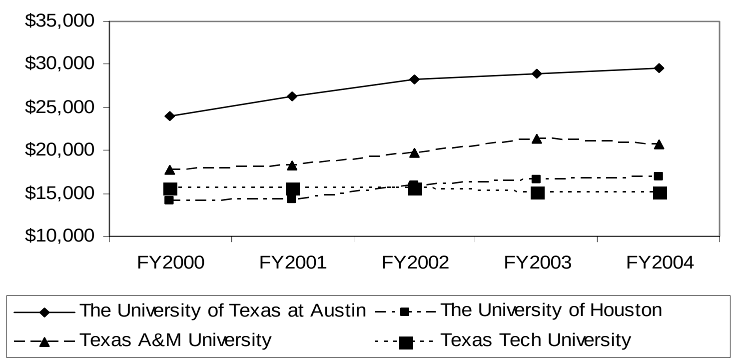
Source: General Appropriations Acts (for General Revenue); institutions' annual financial reports for tuition and fees revenue and for AUF excellence and HEF funding.

While state appropriations have declined as a percentage of higher education revenues, expenses have steadily increased in higher education. However, when adjusted for inflation, expenditures have remained fairly stable over the past five years. The Higher Education Price Index (HEPI) tracks the prices that higher education institutions pay for goods and services in the same manner that the Consumer Price Index (CPI) tracks the prices that consumers pay for goods and services. Since the HEPI began being calculated in 1961, it has consistently increased at a higher rate than the CPI. Although actual prices that higher education institutions pay vary depending on timing and local conditions, the HEPI provides a reliable method for evaluating and analyzing changes in higher education expenditures and identifying potential inefficiencies and cost savings. Figure 2 tracks the total expenditures over the past five years of the four institutions we audited before and after adjusting for changes in the HEPI.

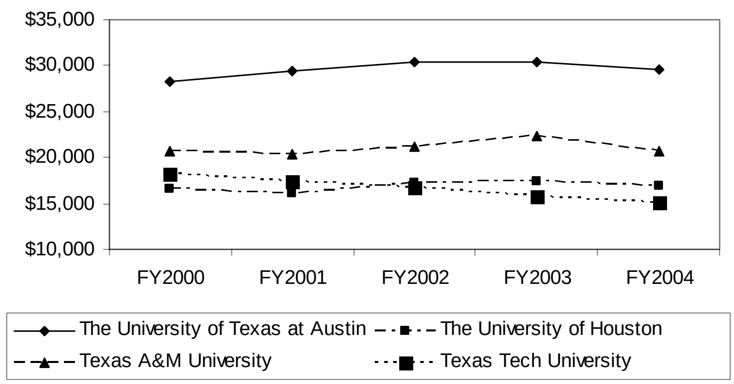
Figure 2

Audited Institutions' Operating Expenditures per Full-Time Student Equivalent (in constant 2004 dollars)

Not Adjusted for the Higher Education Price Index



Adjusted for the Higher Education Price Index



Source: Institutions' annual financial reports

Part 2: Was Revenue from Tuition Increases Used as Planned and Required?

Tables 3–10 provide available information regarding each audited institution's plans and budgets for the uses of increased tuition revenue and each institution's financial aid set-asides and expenditures in the areas for which they planned to use increased tuition revenue. Because information is presented based on the method each institution used to maintain that information, the formats for these tables vary from institution to institution.

Table 3

The University of Texas at Austin		
Fiscal Year 2004		
Category	**Amount Planned**	**Actual Amount**
Financial Aid Set-aside	$4,300,000	$4,501,783
Expenditures in area(s) for which increased tuition revenue was intended to be used:		
Repair and Renovations	11,700,000	11,700,000
Total Expenditures	**$16,000,000**	**$16,201,783**
Revenue from Tuition Increase	$16,000,000	$16,077,795

Sources: Data is from (1) testimony to the Legislature on January 20, 2004, (2) the University of Texas at Austin's operating budget, and (3) the University of Texas at Austin's accounting system.

Table 4

The University of Texas at Austin			
Fiscal Year 2005			
Category	**Amount Planned**	**Amount Budgeted**	**Actual Amount as of March 31, 2005** [a]
Financial Aid Set-aside	$19,700,000	$19,650,589	$19,650,589
Expenditures in areas for which increased tuition revenue was intended to be used:			
Repair and Renovations	16,000,000	16,000,000	6,423,226
Salary/Fringes	25,600,000	22,072,157	14,301,262
New Faculty	2,300,000	1,800,000	1,046,808
Start-Up Costs	6,600,000	5,648,318	1,240,000
Fringes	0	4,885,355	3,056,251
Total Expenditures	**$70,200,000**	**$70,056,419**	**$45,718,136**
Revenue from Tuition Increase	$70,200,000	$70,056,419	$68,495,186

[a] At the time this table was prepared, actual revenue and expenditures were available only through March 31, 2005. No tuition revenue for summer 2005 is included. Actual expenditures should not be used for an actual-to-budget comparison or analysis. They are presented only to indicate that activity has occurred in the intended areas during the fiscal year.

Sources: Data is from (1) testimony to the Legislature on January 20, 2004, (2) the University of Texas at Austin's operating budget, and (3) the University of Texas at Austin's accounting system.

Texas A&M University used a comprehensive budget approach to determine the need for and amount of tuition increases in fiscal years 2004 and 2005. In the summer of 2003, it identified all needs and determined how much of the unmet budget of $38.7 million could be covered by budget cuts in other areas, reallocations, and other sources, such as the $2 per semester credit hour statutory tuition increase and new fees. After taking these adjustments into consideration for fiscal year 2004, adding an additional $5.0 million for waivers and other financial assistance (including a projected set-aside from increased tuition for student financial assistance), a budget shortfall of $5.6 million remained. This amount provided the basis for determining the amount of tuition increases for spring 2004. Texas A&M University followed the same process in determining the amount of designated tuition to charge in fiscal year 2005.

For fiscal year 2004, Texas A&M University projected, budgeted, and received $5.6 million in additional revenue from increased tuition in spring and summer 2004. In fiscal year 2005, it projected increased tuition revenue of $27.7 million, budgeted $27.9 million, and had received $25.0 million as of March 31, 2005.

Because of the method Texas A&M University used for determining the amount of tuition increases and because Texas A&M treated all designated tuition the same for accounting purposes, it is not possible to specify where funds from incremental increases in designated tuition were spent. As a result, the expenditures shown in the tables are incremental increases in expenditures in areas for which increased tuition revenue was intended to be used, as estimated by a year-to-year comparison from the previous year to the current year. Expenditures in both tables, which exceed revenue from increased tuition by significant amounts, were funded by revenue from multiple sources, including the revenue from increased tuition in spring 2004 and fall 2004.

Table 5

Texas A&M University			
Fiscal Year 2004			
Category	**Amount Planned**	**Amount Budgeted**	**Actual Amount**
Financial Aid Set-aside	$ 1,400,000	$ 1,395,171	$ 925,126
Incremental expenditures in areas for which increased tuition revenue was intended to be used:			
Student Initiatives	3,600,000	4,104,111	3,115,410 [a]
Faculty Initiatives	13,700,000	13,733,905	5,172,545 [a]
Other Initiatives (Net of Budget Cuts and Reallocations)	4,600,000	4,263,359	3,845,484 [a]
Total Expenditures	**$23,300,000**	**$23,496,546**	**$13,058,565**

[a] Increased tuition revenue for fiscal year 2004 funded portions of these expenditures, which were also funded from additional revenue sources. These incremental expenditures are estimated by calculating the increase in expenditures of selected financial accounts from August 31, 2003, to August 31, 2004. These estimated expenditures should not be used for actual-to-budget comparisons. They are presented only to indicate that activity occurred in the intended areas during the fiscal year.

Sources: Data is from (1) presentations made by Texas A&M University's president to Texas A&M University students prior to the University's decision to increase tuition, (2) Texas A&M University's operating budget for fiscal year 2004, and (3) Texas A&M University's accounting system.

Table 6

Texas A&M University			
Fiscal Year 2005			
Category	**Amount Planned**	**Amount Budgeted**	**Actual Amount as of March 31, 2005 [a]**
Financial Aid Set Aside	$ 5,192,396	$ 5,192,396	$ 4,032,171
Incremental expenditures in areas for which increased tuition revenue was intended to be used:			
Student Initiatives	6,217,604	8,586,769	12,817,312 [a]
Faculty Initiatives	18,240,000	18,209,326	8,323,221 [a]
Other Initiatives (net of Budget Cuts and Reallocations)	6,970,000	6,343,271	11,379,675 [a]
Total Expenditures	**$36,620,000**	**$38,331,762**	**$36,552,379**

[a] Increased tuition revenue for fiscal year 2004 funded portions of these expenditures, which were also funded from additional revenue sources. These incremental expenditures are estimated by calculating the increase in expenditures of selected financial accounts from March 31, 2004, to March 31, 2005. These estimated expenditures should not be used for actual-to-budget comparisons. They are presented only to indicate that activity occurred in the intended areas during the fiscal year

Sources: Data is from (1) presentations made by Texas A&M University's president to Texas A&M University students prior to the University's decision to increase tuition, (2) Texas A&M University's operating budget for fiscal year 2005, and (3) Texas A&M University's accounting system.

Table 7

Texas Tech University		
Fiscal Year 2004		
Category	**Amount Planned**	**Actual Amount [a]**
Financial Aid Set-aside	$ 941,000	$ 962,050
Expenditures in areas for which increased tuition revenue was intended to be used:		
New Faculty	932,000	0
Merit	1,530,000	1,500,000
Fringes (merit)	382,000	0
Other	0	9,901
Total Expenditures	**$3,785,000**	**$ 2,471,951**
Revenue from Tuition Increase	$ 3,785,000	$ 3,177,547

[a] Actual Amounts are from spring 2004 only; they do not include tuition revenue from the summer session in 2004.

Sources: Data is from (1) testimony to the Legislature and (2) other unaudited information provided by Texas Tech University.

Table 8

Texas Tech University			
Fiscal Year 2005			
Category	**Amount Planned**	**Amount Budgeted**	**Actual Amount as of March 31, 2005[a]**
Financial Aid Set-aside	$ 4,253,768	$4,253,768	$4,632,696
Expenditures in areas for which increased tuition revenue was intended to be used:			
New Faculty	3,587,000	3,587,000	3,530,105
Merit	8,200,000	8,200,000	8,200,000
Fringes (new faculty)	1,516,064	1,516,064	1,516,064
Student Services and Advising	867,457	867,457	542,424
Lab Equipment	882,543	887,543	644,280
Academic Enhancement	1,321,338	1,321,338	250,461
President's Scholarship Fund	2,000,000	2,000,000	2,000,000
Faculty Start-Up (Fiscal Year 2004 Roll Forward)	0	1,345,321	202,272
Total Expenditures	**$22,628,170**	**$23,978,491**	**$21,518,302**
Revenue from Tuition Increase	$22,628,170	$22,628,170	$19,912,405

[a] At the time this table was prepared, actual revenue and expenditures were available only through March 31, 2005. No tuition revenue for summer 2005 is included. Actual expenditures to date should not be used for an actual-to-budget comparison or analysis. They are presented only to indicate that activity has occurred in the intended areas during the fiscal year.

Sources: Data is from (1) testimony to the Legislature and (2) other unaudited information provided by Texas Tech University.

Table 9

University of Houston			
Fiscal Year 2004			
Category	**Amount Planned**	**Amount Budgeted**	**Actual Amount**
Financial Aid Set-aside	$1,820,675	$1,820,675	$1,482,303
Expenditures in areas for which increased tuition revenue was intended to be used:			
Graduate Assistant Tuition Fellowships	4,164,000	4,164,000	4,116,950
Health Insurance Subsidy	1,373,223	1,896,442	1,554,859
Presidential Grad Fellowship	458,448	458,448	458,448
Undergraduate Scholarships	701,584	701,584	5,174,910
Total Expenditures	**$8,517,930**	**$9,041,149**	**$12,787,470**
Revenue	$8,517,930	$8,517,930	$7,115,886
Sources: Data was obtained from (1) information provided to the Joint Interim Committee on Higher Education on January 20, 2004, (2) response provided to the Legislative Oversight Committee on Higher Education on June 8, 2004, and (3) unaudited information provided by the University of Houston.			

Table 10

University of Houston			
Fiscal Year 2005 General Deregulated Designated and Differential Tuition			
Category	**Amount Planned**	**Amount Budgeted [a]**	**Actual Amount as of April 13, 2005 [b]**
Financial Aid Set-aside	$4,305,908 [c]	$4,305,908 [c]	$5,976,768
Expenditures of Revenue from Tuition Increase:			
Differential expenditures for Various Schools and Colleges	5,666,131	3,213,686	1,228,028
Institutional Commitments	5,927,936	28,904,416	9,246,115
Academic Commitments	11,121,956	12,618,816	4,341,340
Administrative Commitments	3,021,442	3,788,409	2,038,235
University Advancement	45,000	948,028	481,118
Total Expenditures	**$30,088,373**	**$53,779,263**	**$23,311,604**
Revenue from Tuition Increase	$30,209,914	$30,209,914	$26,768,560 [d]

[a] Amount budgeted draws on multiple sources of funding, including revenue from increased tuition.

[b] These expenditures were funded from multiple sources of revenue, including increased tuition revenue. At the time this table was prepared, actual expenditures for fiscal year 2005 were available only for the first seven months of that fiscal year. As a result, actual expenditures in the last column indicate only that activity has occurred in the intended areas during the fiscal year. They should not be used for an actual-to-budget comparison or analysis.

[c] Excludes financial aid set aside from differential tuition.

[d] Actual gross revenue from increased tuition is as of April 13, 2005.

Sources: Data was obtained from (1) information provided to the Joint Interim Committee on Higher Education on January 20, 2004, (2) response provided to the Legislative Oversight Committee on Higher Education on June 8, 2004, and (3) unaudited information provided by the University of Houston.

Cost-Savings Measures Implemented by the Four Audited Institutions

While it is difficult to analyze costs across an entire institution, it is possible to conduct a cost analysis and recommend improvements in efficiency and effectiveness in one specific area of higher education operations, especially in the business functions. Institutions routinely perform this kind of analysis to reduce costs and improve services.

When determining the necessity and amounts of tuition increases beginning in spring 2004, each institution's tuition policy advisory committee analyzed and quantified the institution's unmet needs that fell within the definitions of House Bill 3015. They also analyzed the current budget capacity and possibilities for cost savings and reallocations. The following are examples of cost-savings measures developed and/or implemented by the audited institutions in the 2004–2005 biennium:

- The University of Texas at Austin, in planning the amount of tuition increases for academic year 2003–2004, reported $38.7 million in budget reductions for that year, including a $25 million cut in college and vice president budgets. The Legislative Budget Board's March 2005 performance report on the University of Texas at Austin also reports on the university's "best practice" methodology for determining and realizing maximum cost-benefit from efficiency improvements in major cost centers, such as the integration of office supply procurement, networked office machines, and automated services for students and staff.
- Texas A&M University reported a 6.6 percent cut in administrative, college, and library budgets totaling $20.4 million before determining the amount of tuition increase for academic year 2003–2004. The Legislative Budget Board's January 2005 performance report on Texas A&M University called this reallocation process "exemplary" and noted additional areas in which Texas A&M could realize significant savings, such as by combining its decentralized business functions.
- Texas Tech University is currently implementing cost-savings recommendations from an external study conducted in 2004 of potential efficiencies across all operations. Initiatives that Texas Tech University has begun include improvements in strategic sourcing of high-spend commodities, energy management, business processes, and shared service agreements for administrative functions.
- The University of Houston reported reducing operating budgets by $9.2 million and utilizing available fund balances of approximately $2.6 million to help minimize the increase in designated tuition during fiscal year 2004. It has also developed an Internal Customer Service Center in the Finance Division to ensure that cost savings and efficiency are constantly addressed throughout the university. This center provides internal customer service to university offices, units, and departments and is staffed with consultants, trainers, and documentation developers. The University of Houston believes that this centralized service is relatively

unique in higher education. The University of Houston reports having implemented savings initiatives in key functions over the past 24 months, such as a transition from manual to electronic functions and imaging applications in key business and service areas, the rebidding of contracts for better value, and the elimination of the position of vice president for administration. The University of Houston reports that completed initiatives are producing annualized savings of at least $8.3 million and that another $14.4 million in savings initiatives are currently in process.

Part 3: Were Tuition Increases Reasonable When Measured Against Non-Accounting Criteria?

To assess reasonableness of the tuition increases implemented by the four audited institutions, we assembled separate peer groups for each institution and developed comparisons for key indicators. We drew on each institution's own peer group selections, as well as other widely accepted groupings. In each case, we selected institutions that are recognized as leading public institutions of higher education and that, across multiple criteria, are similar to the Texas institution with which they are being compared in this report. Table 11 below lists the peer institutions for each audited institution.

Table 11

Audited Institutions' Peer Groups	
The University of Texas at Austin	**Texas A&M University**
Indiana University - Bloomington	Georgia Institute of Technology
The Ohio State University	The Ohio State University
The University of California – Berkeley	Oklahoma State University
University of Illinois at Urbana-Champaign	University of California – Davis
University of Michigan - Ann Arbor	University of Florida
University of Minnesota - Twin Cities	University of Illinois at Urbana-Champaign
The University of North Carolina at Chapel Hill	University of Minnesota - Twin Cities
University of Wisconsin - Madison	The University of North Carolina at Chapel Hill
Texas Tech University	**University of Houston**
California Polytechnic State University - San Luis Obispo	The University of Alabama at Birmingham
Iowa State University	University of Cincinnati - Main Campus
Michigan State University	University of Illinois at Chicago
North Carolina State University	University of South Carolina - Columbia
Oklahoma State University	University of Pittsburgh
University of Colorado at Boulder	The University of Utah
University of Nebraska - Lincoln	University of Wisconsin - Milwaukee
Virginia Polytechnic Institute and State University	Wayne State University

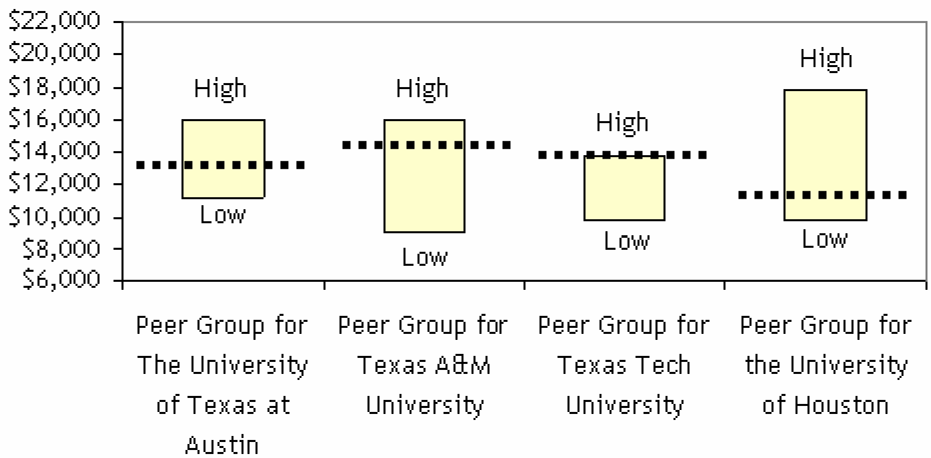
Figures 3–9 show the results of our peer group comparisons.

Figure 3

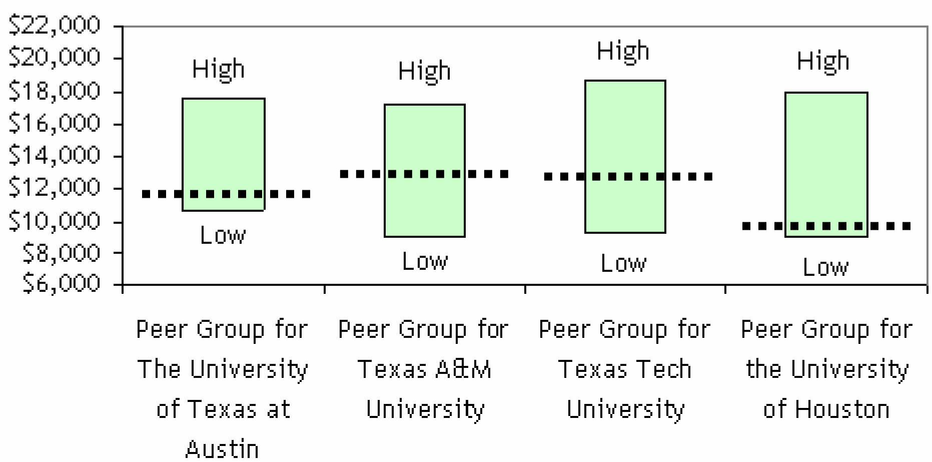
Tuition, Mandatory Fees, Room, and Board
Academic Year 2004-2005

Audited Institutions' Peer Group Comparison

Adjusted for Cost-of-Living Differences Among States



Not Adjusted for Cost-of-Living Differences Among States

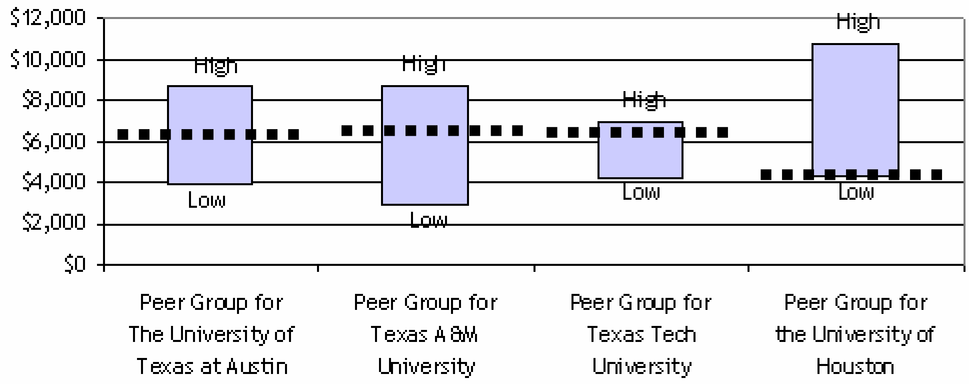


Represents the audited institution's placement in its peer group

Source: Institutions' Common Data Sets

Figure 4

Tuition and Fees Adjusted for Differences in Cost of Living Among States
Audited Institutions' Peer Comparison, Academic Year 2004-2005

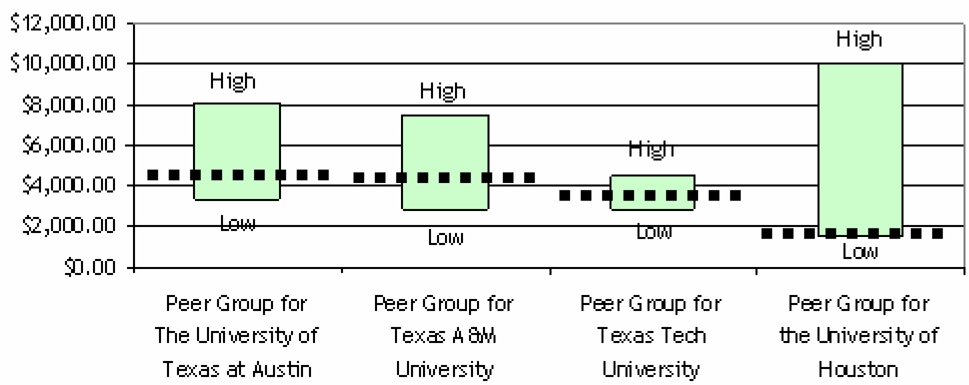


Reflects audited institution's placement in its peer group

Source: Institutions' Common Data Sets

Figure 5

Tuition Adjusted for Differences in Cost of Living Among States
Audited Institutions' Peer Comparison, Academic Year 2004-2005

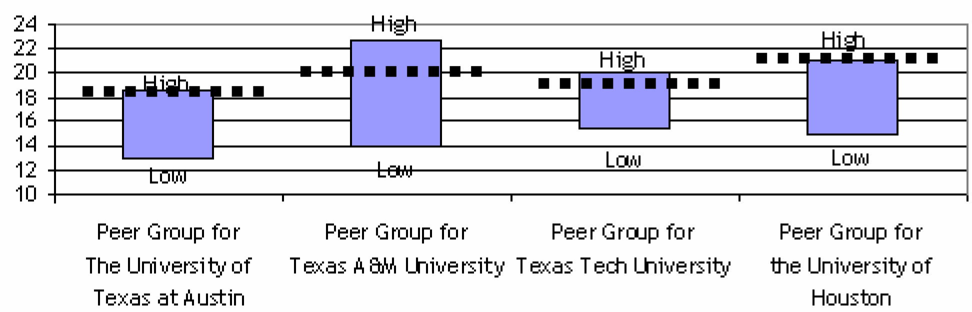


Reflects audited institution's placement in its peer group

Source: Institutions' Common Data Sets

Figure 6

Student/Faculty Ratio
Audited Institutions' Peer Comparison, Academic Year 2004-2005



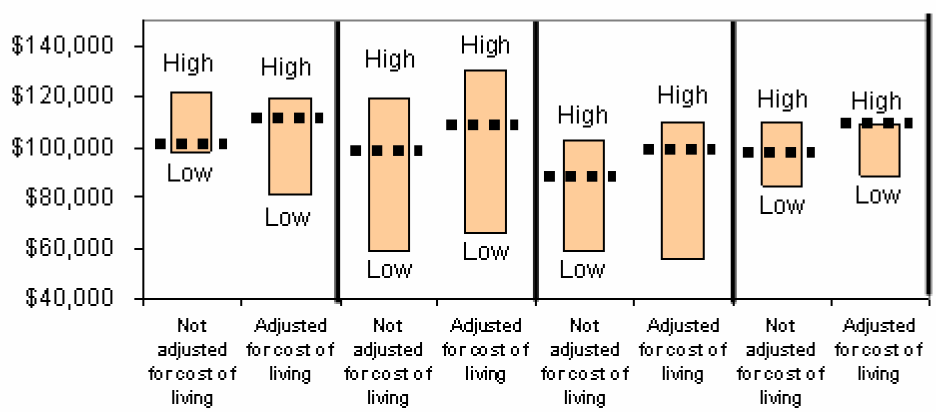
Reflects audited institution's placement in its peer group

Note: A low student/faculty ratio is desirable because it indicates smaller class sizes.

Source: Institutions' Common Data Sets

Figure 7

Average Faculty Salaries
Adjusted and Not Adjusted for Cost-of-Living Differences Among States
Audited Institutions' Peer Comparison, Academic Year 2004-2005

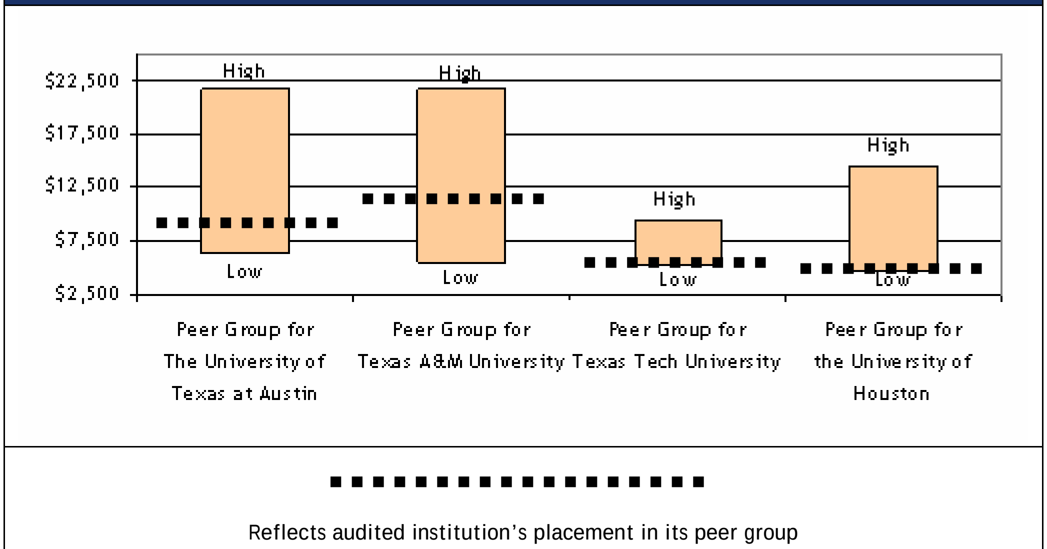


Reflects audited institution's placement in its peer group

Source: Lombardi Center, the University of Florida

Figure 8

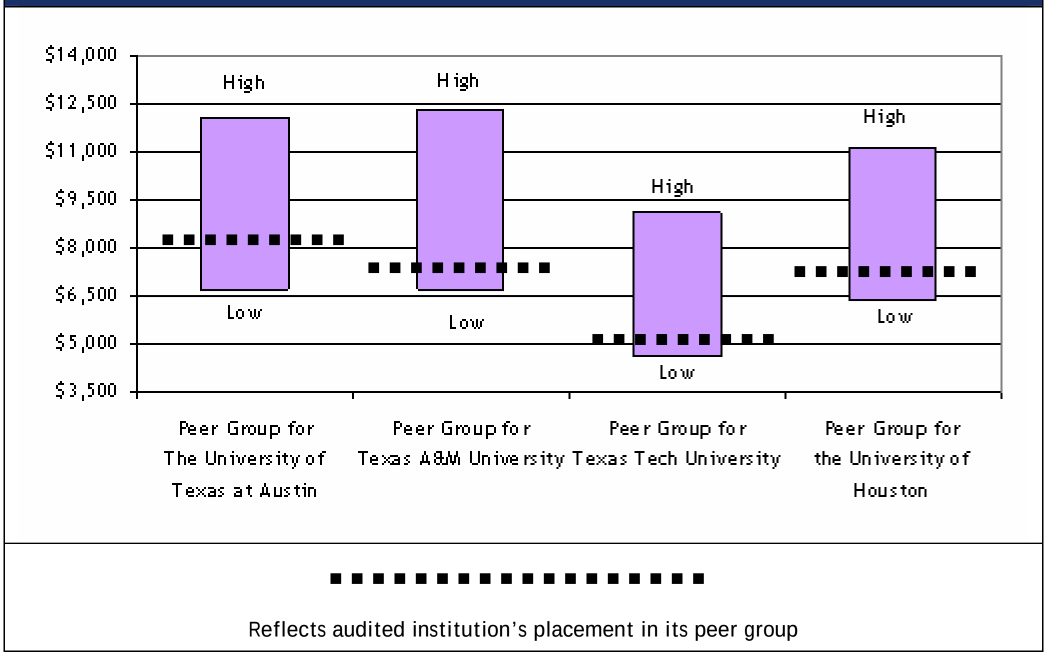
Instructional Expense per Full-Time Student Equivalent
Audited Institutions' Peer Comparison, Fiscal Year 2003



Source: The National Center for Education Statistics' Integrated Postsecondary Education Data System

Figure 9

Average Total Grant Aid per Student (Federal, State, and Institutional Aid)
Received by Full-Time, First-Time, Degree/Certificate-Seeking Undergraduates
Audited Institutions' Peer Comparison, Academic Year 2001-2002



Source: The National Center for Education Statistics' Integrated Postsecondary Education Data System

We were unable to report research expenditures by peer group because of inconsistencies in the ways the four audited institutions reported research expenditures for fiscal year 2002 to the Coordinating Board and to the National Science Foundation (NSF). These inconsistencies are not explained by the differences in the reporting guidelines of the Coordinating Board and the NSF.

Audited Institutions' Progress in Key Performance Areas

Texas Education Code, Section 54.0515(e), requires that each institution, as a condition to tuition deregulation, reasonably implement the following:

- Make satisfactory progress towards the goals provided in its master plan for higher education and in "Closing the Gaps," the State's master plan for higher education; and
- Meet acceptable performance criteria, including measures such as graduation rates, retention rates, enrollment growth, educational quality, efforts to enhance minority participation, opportunities for financial aid, and affordability.

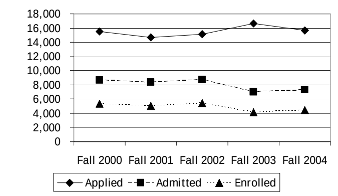
Figure 10 shows the trends in audited institutions' applications, admissions, and enrollment by ethnicity. As this figure illustrates, applications, admissions, and enrollment of black and Hispanic students have generally been increasing.

Figure 10

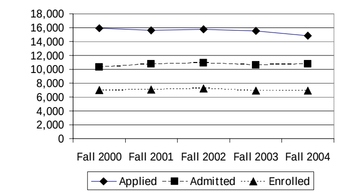
Audited Institutions' Applications, Admissions, and Enrollment for White, Black, and Hispanic Students (First-Year College and New Transfer Students, Fall 2000-Fall 2005)

White Students

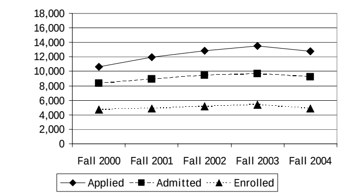
The University of Texas at Austin



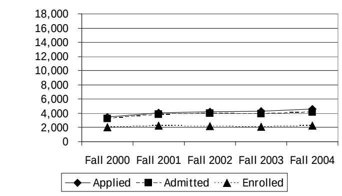
Texas A&M University



Texas Tech University

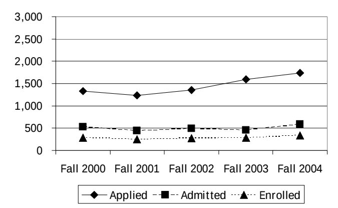


University of Houston

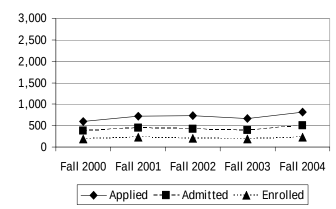


Black Students

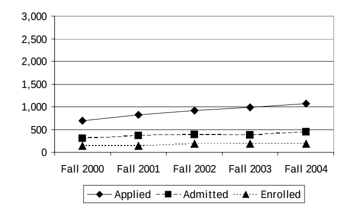
The University of Texas at Austin



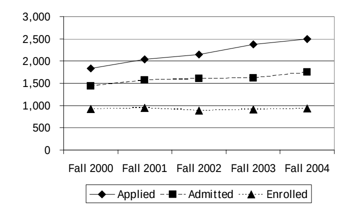
Texas A&M University



Texas Tech University

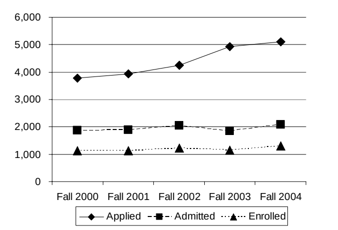


University of Houston

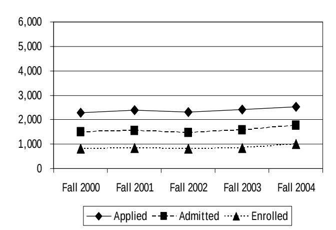


Hispanic Students

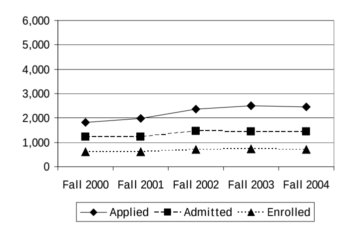
The University of Texas at Austin



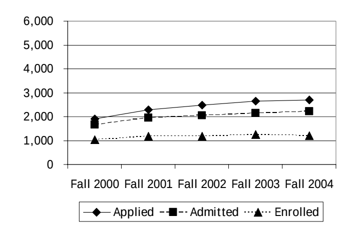
Texas A&M University



Texas Tech University



University of Houston



Source: Demographic information from each institution. Charts for each group of students are presented with different scales to present the information in a more readable format.

The number of Hispanic and black students who enrolled at each of the four audited institutions increased, in some cases significantly, from 2000 to 2004. However, the proportion of the student body represented by Hispanic and black students increased only slightly over the same period, remaining well below the proportion of Hispanic and black people in the State's population at large. Lesser improvement in this area indicates that underrepresentation in higher education remains a significant challenge to full participation.

The following tables provide additional information on the audited institutions' performance in the areas of student body diversity, freshman retention, school completion as measured by four- and six-year graduation, student/faculty ratios, class size, students' employment after graduation, and research and development expenditures.

Table 12

Improvement in Ensuring the Return of First-Year Students (Retention) at Audited Institutions

Institution	Fall 2000	Fall 2001	Fall 2002	Fall 2003	Fall 2004
The University of Texas at Austin	89.8%	90.6%	90.7%	91.8%	93.2%
Texas A&M University	88.4%	88.1%	89.4%	89.0%	90.0%
Texas Tech University	78.6%	80.3%	82.3%	82.0%	82.0%
University of Houston	75.9%	78.0%	78.5%	79.0%	78.0%

Source: Fall 2000 through fall 2002 - Texas Public Universities' Data and Performance Report, Texas Higher Education Coordinating Board (June 2002, May 2003, and August 2004); fall 2003 through fall 2004 – Common Data Sets for 2003 and 2004 posted on each institution's Web site.

Table 13

Improvement in School Completion Rate (Four- and Six-Year Graduation Rates) at Audited Institutions			
	Fiscal Year 2000	Fiscal Year 2002	Fiscal Year 2004
The University of Texas at Austin			
Four-Year Graduation Rate	36.2%	37.0%	42.1%
Six-Year Graduation Rate	70.0%	73.7%	73.8%
Texas A&M University			
Four-Year Graduation Rate	27.5%	31.2%	36.4%
Six-Year Graduation Rate	76.7%	78.2%	79.2%
Texas Tech University			
Four-Year Graduation Rate	24.0%	27.0%	25.3%
Six-Year Graduation Rate	56.7%	60.3%	64.0%
University of Houston			
Four-Year Graduation Rate	11.8%	10.2%	11.5%
Six-Year Graduation Rate	43.8%	44.5%	46.7%
Source: Texas Higher Education Coordinating Board's Higher Education Accountability System			

Table 14

Improvement (Reduction) in Student/Faculty Ratio (Average Number of Students per Faculty Member) at Audited Institutions				
Institution	Fiscal Year 2000 Student/Faculty Ratio	Fiscal Year 2002 Student/Faculty Ratio	Fiscal Year 2004 Student/Faculty Ratio	Target Student/Faculty Ratios
The University of Texas at Austin	19.1	19.5	17.8	17.3
Texas A&M University	19.2	19.2	18.0	17.5
Texas Tech University	17.4	18.7	18.2	17.2
University of Houston	20.9	21.5	21.5	20.5
Source: Texas Higher Education Coordinating Board				

Table 15

Improvement in Class Size at Audited Institutions				
Institution	**Fall 2000**	**Fall 2002**	**Fall 2004**	**Improvement (increase in percentage) from Fall 2000 to Fall 2004**
Percent of Classes with Fewer than 20 Students				
The University of Texas at Austin	33.8%	32.4%	33.3%	(0.5%)
Texas A&M University	11.2%	23.8%	22.7%	11.5%
Texas Tech University	33.0%	32.2%	30.9%	(2.1%)
University of Houston	21.5%	20.6%	20.8%	(0.7%)
Percent of Classes with More than 50 Students				
Institution	**Fall 2000**	**Fall 2002**	**Fall 2004**	**Improvement (decrease in percentage) from Fall 2000 to Fall 2004**
The University of Texas at Austin	20.7%	23.2%	23.3%	2.6%
Texas A&M University	22.4%	22.1%	20.4%	(2.0%)
Texas Tech University	10.9%	12.9%	13.6%	2.7%
University of Houston	28.0%	28.2%	26.6%	(1.4%)
Source: Texas Higher Education Coordinating Board Accountability System				

Table 16

Improvement in Number of Students Gaining Employment or Entering Professional or Graduate School in Texas Immediately after Graduation at Audited Institutions			
Institution	**Fiscal Year 2001**	**Fiscal Year 2002**	**Fiscal Year 2003**
The University of Texas at Austin	77.5%	76.6%	77.7%
Texas A&M University	84.1%	83.4%	83.5%
Texas Tech University	86.3%	86.5%	85.9%
University of Houston	85.7%	87.5%	86.5%
Statewide Average	86.0%	85.3%	85.6%
Source: Texas Higher Education Coordinating Board Accountability System			

Table 17

Increases in Research and Development Expenditures at Audited Institutions							
Institution	**Fiscal Year 2000**	**Fiscal Year 2001**	**Fiscal Year 2002**	**Fiscal Year 2003**	**Fiscal Year 2004**	**5-Year Percentage Increase**	**Percent of Total State Expenditures**
The University of Texas at Austin	$295,901,287	$321,580,736	$366,355,359	$376,403,651	$382,391,771	29.2%	34.5%
Texas A&M University [a]	$331,027,971	$340,660,614	$372,828,854	$390,305,058	$390,654,670	18.0%	35.2%
Texas Tech University	$44,110,624	$43,373,437	$51,701,449	$56,147,235	$48,142,661	9.1%	4.3%
University of Houston	$58,729,891	$61,332,253	$82,865,307	$88,608,021	$75,927,432	29.3%	6.8%
Total Research and Development Expenditures Statewide	$881,270,555	$948,223,316	$1,076,789,336	$1,118,412,186	$1,109,601,581	25.9%	

[a] Research expenditures for Texas A&M University include expenditures by the Texas A&M service agencies, for which Texas A&M University faculty also conduct research. These figures are not strictly comparable with those for the University of Texas at Austin, which do not include expenditures from its service agencies, such as the McDonald Observatory or the Bureau of Economic Geology. This difference in reporting is an issue yet to be resolved by the Texas Higher Education Coordinating Board. Research expenditures for Texas A&M University in fiscal year 2004, without including the service agencies, were $61,993,044.

Source: Texas Higher Education Coordinating Board

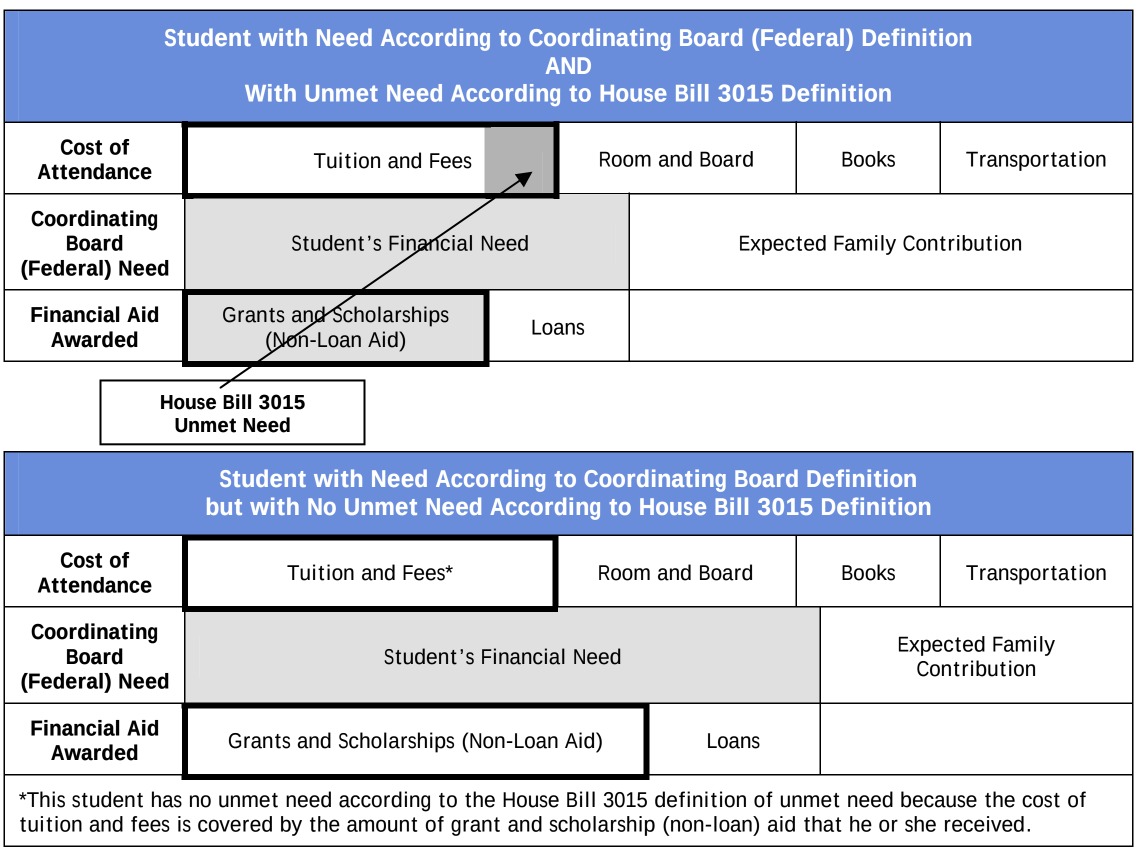
Part 4: Did Audited Institutions Award Student Financial Aid from Revenue from Increased Tuition as Required?

House Bill 3015 specified that "priority shall be given to students who meet the coordinating board definition of financial need and whose cost for tuition and required fees is not met through other non-loan financial assistance programs."

Following the House Bill 3015 definition of unmet need, a student with greatest need according to the Texas Higher Education Coordinating Board's (Coordinating Board) definition (which is also the federal definition) would most likely have enough non-loan aid to cover the total cost of tuition and fees. The statute requires that students who meet the Coordinating Board's definition of need and who do *not* have enough non-loan aid to cover the cost of tuition and fees are to be given priority in the award of the tuition financial aid set-aside.

Figure 11 illustrates the difference between (1) a student with unmet need as defined by House Bill 3015 and (2) a student without unmet need as defined by House Bill 3015 but who has financial need according to the Coordinating Board definition. The latter student, with financial need but with no unmet need as defined by House Bill 3015, does not qualify for priority in awards of funds set aside from revenue from increased tuition.

Figure 11



Only one of the audited institutions—Texas Tech University—performed the calculation necessary to identify the students to whom House Bill 3015 required priority to be given in awarding the set-aside for student financial aid from increased tuition revenue. However, the other three audited institutions appear to have acted in good faith in attempting to meet their understanding of student need in awarding financial aid. In addition, as Table 18 shows, some institutions set aside significantly more than they were required to set aside.

Table 18

Amounts Audited Institutions Set Aside from Increased Tuition Revenue for Student Financial Aid Required by House Bill 3015					
Minimum Amount Required to be Set Aside					
Semester(s)	Category of Tuition	Amount of Increased Tuition Revenue above $46 per Semester Credit Hour	Minimum Required Set-Aside for Category (20% for resident undergraduate; 15% for resident graduate)	Actual Amount Institution Set Aside	Amount Institution Set Aside Above Minimum
The University of Texas at Austin					
Spring 2004, Fall 2004, and Spring 2005	Resident Undergraduate	$63,188,238	$12,637,648		
	Resident Graduate	$7,252,338	1,087,851		
		Total	**$13,725,499**	**$24,183,997**	**$10,458,498**
Texas A&M University					
Spring 2004, Fall 2004, and Spring 2005	Resident Undergraduate	$27,560,880	$5,512,176		
	Resident Graduate	$1,258,172	188,726		
		Total	**$5,700,902**	**$5,717,014**	**$16,112**
Texas Tech University					
Spring 2004, Fall 2004, and Spring 2005	Resident Undergraduate	$22,351,848	$4,470,370		
	Resident Graduate	$738,104	110,716		
		Total	**$4,581,086**	**$5,594,746**	**$1,013,660**
University of Houston					
Spring 2004 and Fall 2004	Resident Undergraduate	$24,261,663	$4,852,332		
	Resident Graduate	$5,917,279	$887,592		
		Total	**$5,739,924**	**$7,459,071**	**$1,719,147**
		Totals for all institutions	**$29,747,411**	**$42,954,828**	**$13,207,417**
Source: Information was consolidated from data provided by each institution's department of financial reporting, department of student financial services, and director of budgets.					

The State Auditor's Office performed a priority analysis based on the House Bill 3015 definition of unmet need that was retrospective for spring 2004 and fall 2005 and based on mid-semester data for spring 2005. To perform this analysis, we obtained the student financial aid and student billing/payment databases for the period of interest from the four institutions. Our population of eligible students for spring 2005 is overstated by the number of students identified as eligible who have since become ineligible because of receiving additional non-loan aid. Table 19 shows the results of our analysis for each of the four audited institutions.

Table 19

Calculation of Awards from Tuition Revenue Set-Aside According to the House Bill 3015 Definition of Unmet Need (Calculation was retrospective for spring and fall 2004 and made at mid-semester for spring 2005)

	The University of Texas at Austin	Texas A&M University	Texas Tech University	University of Houston	Totals for All Institutions
Total number of students over three semesters (cumulative total) who qualified for priority in awards from set-aside tuition revenue (students who met HB 3015 definition of unmet need) [a]	27,643	25,074	20,851	21,515	95,083
Total cumulative number of tuition set-aside awards over three semesters made to students who qualified for priority in awards from tuition set-aside funds	21,250	1,983	5,697	3,960	32,890
Total cumulative tuition set-aside dollars awarded to students over three semesters qualifying for priority in award of set-aside funds	$8,436,661 (54.8% of total $ awarded)	$1,423,043 (34% of total $ awarded)	$2,164,880 (85% of total $ awarded)	$2,873,566 (68.6% of total $ awarded)	$14,898,150 (56.6% of total $ awarded)
Total cumulative number of tuition set-aside awards over three semesters that could have been made to qualifying students with priority but were not	6,397	23,091	15,153	17,555	62,196
Total cumulative dollar amount of unmet need over three semesters according to HB 3015 [b]	$49,770,292	$47,365,877	$32,687,040	$72,425,599	$202,248,808
Total cumulative number of awards over three semesters made to students with no unmet need according to HB 3015 definition	12,962	1,570	1,058	2,654	18,244
Total cumulative tuition set-aside dollars awarded over three semesters to students with no unmet need according to HB 3015 definition	$6,970,810 (45.2% of total $ awarded)	$2,757,339 (66% of total $ awarded)	$380,509 (15% of total $ awarded)	$1,315,223 (31.4% of total $ awarded)	$11,423,881 (43.4% of total $ awarded)

[a] All totals are cumulative over three semesters, including duplicate counts for awards made (or due) to the same eligible or ineligible students for more than one semester.

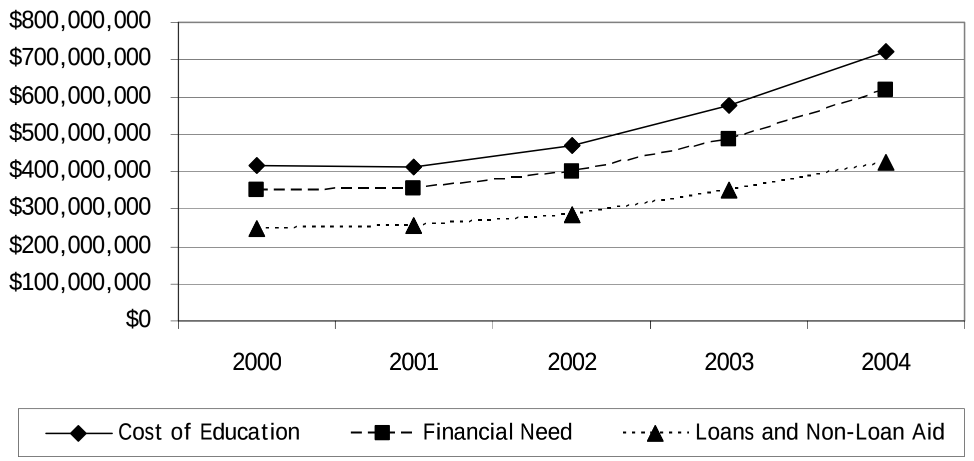
[b] Over the three semesters included in this analysis, the four audited institutions set aside a total of $42,954,828 for student financial aid to be distributed as required by House Bill 3015, $13.2 million more than required by the law. The total amount set aside, if distributed in compliance with House Bill 3015, would have covered 21 percent of total unmet need as defined by House Bill 3015. The number of awards and the amounts of awards varied greatly among the four institutions because the bill did not specify the amount of an award from these funds.

Source: All calculations were based on self-reported student financial aid and billing information from the four audited institutions for all students with financial need according to the Coordinating Board (and federal) definition.

Figure 12 presents trends in the total cost of attendance, financial need, and loans and non-loan aid at the four audited institutions. Cost of attendance includes tuition and fees, any room and board, books, transportation, and miscellaneous expenses for the total number of students enrolled for each fiscal year. As Figure 12 shows, both the cost of attendance and financial need are growing at a faster rate than loans and non-loan aid.

Figure 12

Trends in Total Cost of Attendance, Financial Need, and Loan and Non-Loan Aid at the Audited Institutions



Source: Texas Higher Education Coordinating Board

Part 5: Did Audited Institutions Have Fund Balances that Could Be Spent to Mitigate Future Tuition Increases?

There are no accepted general criteria for evaluating the reasonableness of unrestricted fund balances maintained by higher education institutions. In the absence of such criteria, we reviewed a sample of 3 of the 12 funds[1] used in higher education fiscal administration: unexpended plant funds, service department funds (which are part of the educational and general or designated funds), and endowment funds.

From the 9,033 accounts within those funds at the four audited institutions, we selected 601 accounts for further evaluation. Those accounts had balances or transfer activity that appeared to be excessive or questionable according to the conditions in Table 20 and based on the purpose of the account.

Table 20

Accounts that Met Conditions for Further Evaluation			
	Unexpended Plant Funds	**Service Department Accounts within the Educational and General or Designated Funds**	**Endowment Funds**
Conditions for Further Evaluation	▪ Accounts with little or no activity in at least two of the last five fiscal years ▪ Accounts whose annual activity did not decrease the balance over time	▪ Balances as of August 31, 2004, that exceeded 25 percent (three months' worth) of annual expenditures ▪ Accounts with little or no activity in the last five fiscal years	▪ Accounts created since September 1, 2000, for which the primary funding source was not donor gifts ▪ Accounts created prior to September 1, 2000, that received significant non-gift funding in the last five fiscal years
Number of Accounts that Met Conditions for Further Evaluation			
The University of Texas at Austin	308	42	76
Texas A&M University	8	33	25
Texas Tech University	22	33	20
University of Houston	16	10	8

For 249 of these 601 accounts, the institutions provided explanations for the balances in the unexpended plant fund and service department accounts and for the specific transaction activity for endowment fund accounts. We provided information from our review of the remaining 352 accounts to the

[1] The 12 fund types include educational and general, designated, auxiliary enterprises, restricted, loan, endowment, annuity and life income, unexpended plant, renewals and replacements, retirement of indebtedness, investment in plant, and agency. We focused on unexpended plant funds, service department funds (which are part of the educational and general or designated funds) and endowment funds for the following reasons:

(1) Unexpended plant accounts hold large dollar amounts for capital-related projects and are subject to periods of significant activity and periods of extended dormancy, allowing balances to build unnecessarily if they are not monitored regularly.

(2) In service department accounts, users are charged based on agreed-upon rates for the services. If the rates are not managed appropriately and adjusted downward as needed, balances can build in these accounts.

(3) Institutions can move undedicated funds into endowment accounts for future, unspecified uses. Therefore, these funds could be used to offset operating expenses and mitigate the need for tuition increases.

institutions for their own analysis. Institutions' responses for unexpended plant fund and service department accounts are summarized as follows:

- **Unexpended Plant Fund Accounts.** Institutions frequently responded that they planned to use the funds in these accounts for future plant-related projects funded by those accounts or other plant-related accounts. For example, some responses mentioned that institutions were holding funds for deferred maintenance associated with unspecified projects.

- **Service Department Accounts.** Institutions frequently responded that they use surplus funds in these accounts to reduce rates they charge for services such as computing services (when there are deficits in these accounts, institutions also increase the rates they charge for services). Institutions also responded that they use surplus funds in these accounts to make capital upgrades in areas such as telecommunications. Additionally, institutions' responses indicated that if any surpluses were determined to have resulted from activities funded with federal money, the institutions would need to reimburse the federal government (for example, by reducing future rates charged to activities funded with federal money) and that it would be improper to transfer these funds to another account.

In the case of endowment funds, we did not identify any questionable diversions of funds. However, it is important to note that institutions' management and their boards of regents decide when to use unrestricted funds to create quasi-endowment funds, which are not technically endowment funds but are created by the institution to function as endowment funds. Because institutions have significant flexibility in creating quasi-endowment funds, we were unable to assess the reasonableness of the balances in these funds.

Because of institutions' flexibility in managing funds, for the most part we could not conclusively identify accounts with surplus funds that could be used to mitigate tuition increases. However, our analysis identified four account balances that the institutions agreed had surplus funds that would be used to support future operating budgets, thus potentially mitigating future tuition increases, at least for the short term. These account balances included the following:

- A $1 million dormant unexpended plant fund account at Texas A&M University. The institution stated that it planned to make those funds "available to help fund future years' educational and general budgets or one-time needs."

- A total of $96,479 from three projects within a $23 million unexpended plant fund account at Texas A&M University. The institution responded that the projects were completed and that it had transferred or will transfer the balances back to the original funding accounts.

- A $3.6 million designated fund service department account at Texas Tech University for which the balance exceeded nine times the total annual expenditures. Texas Tech University reported that it had identified the account in 2004 and has subsequently taken action to "prevent the recurrence of an excessive fund balance." It also reported that it planned to use $1.5 million of these funds to support the operating budgets for fiscal years 2006 and 2007, thus "mitigating tuition increases." Texas Tech University provided other plans for the remainder of those funds such as reducing service charges, refunding federal overcharges, and transferring some of the balance to an account deemed underfunded.

- A $209,921 dormant unexpended plant fund account at Texas Tech University. The institution reported that this account was originally funded with designated funds, it had closed this account on April 22, 2005, and "[t]he funds were returned to the original source."

Our analysis also identified numerous other examples of account balances that met our conditions for further evaluation for which institutions asserted that they would use surplus funds in the future for the same account or for a different account.

Each institution has formal or informal policies and procedures to periodically review the types of accounts covered by our analysis. Our audit objectives did not include specific tests of each institution's adherence to its stated procedures. In general, the institutions asserted that they perform such account balance reviews at least annually. The University of Texas at Austin, Texas A&M University, and the University of Houston provided information about formal procedures for reviewing service department balances. Texas Tech University indicated that it did not have formal review procedures for these balances but that management performs periodic informal reviews. The procedures for the three institutions with formal procedures suggest that each institution would periodically review the rates charged by its service departments to ensure that any surpluses or deficits that developed were eliminated by adjusting future rates rather than by transferring out any excess funds. The University of Texas at Austin was the only institution that provided formal policies for periodically reviewing unexpended plant fund account balances and endowment accounts.

Our analysis of the five-year history of unexpended plant fund and service department accounts, as well as the institutions' responses to our balance inquiries, suggest that the institutions' own review processes have identified dormant or surplus balances. In those cases, the institutions reported that they have taken corrective action (for example, by transferring balances out of accounts that no longer need the funds or by reducing billing rates to user departments).

However, this analysis and some institution responses also provide empirical evidence that some prior internal balance reviews might not have been performed as effectively or as comprehensively as possible to identify surplus funds promptly. For example, we observed numerous unexpended plant fund accounts with project-specific account titles (for example, fire damage repair to a specific building or renovation of a specific room or lab) that had no monetary activity for at least four years. Although we did not ask to see construction records, based on the description of these projects it is likely that some or all of them (many with balances below $50,000) were completed long enough ago that thorough annual account reviews should have already closed them out and transferred these unspent balances.

We made similar observations on some non-construction accounts, to which the institutions responded that during fiscal year 2005 they transferred to other uses the balances no longer needed in those accounts. However, the period of inactivity or size of the surplus balance in relation to the accounts' normal level of expenditures raised a question regarding why review procedures did not identify these amounts sooner. Therefore, the institutions might wish to review their current policies and procedures to ensure that they are properly designed and consistently implemented to promptly identify and address all surplus funds no longer needed in specific accounts.

Summary of Objectives, Scope, and Methodology

Our objectives were to:

- Determine whether the basis and methodologies used to support tuition and fee increases that occurred as a result of House Bill 3015 (78th Legislature) appear reasonable.
- Evaluate whether tuition and fee increases have been utilized as planned and required.
- Assess whether the institutions appear to be maintaining excessive unrestricted fund balances, some of which could be spent to mitigate future tuition increases.

The audit scope covered four institutions: The University of Texas at Austin, Texas A&M University, Texas Tech University, and the University of Houston. The scope included these institutions' documents and electronic records spanning the period from September 1, 1999, to March 31, 2005.

The audit methodology included the following:

- Review of research regarding the relationship between tuition increases, tuition and fee increases, student financial aid, and enrollment patterns.
- Analysis of each audited institution's process and methodology for determining the need for increases in tuition in 2004 and 2005.
- Review of each audited institution's cost-savings and reallocation efforts prior to determining the amount of tuition increases needed.
- Analysis of each audited institution's calculations of areas and amounts of need and projected revenues from increased tuition.
- Analysis of tuition and fees, cost of attendance, median family income, and enrollment demographics from 2000 to 2005.
- National peer group comparisons of tuition and fees, expenditures, and key performance indicators.
- A review of audited institutions' budgets, revenues, and expenditures from September 1, 1999, to March 31, 2005, in areas of expenditures funded by increased tuition revenue.
- Analysis of compliance with House Bill 3015 with regard to tuition increases and structure, set-asides for student financial aid, and the distribution of that aid.
- Analysis of balances in 9,033 accounts in endowment funds, unexpended plant funds, and service department funds within education and general or designated funds.

This audit was conducted in accordance with generally accepted government auditing standards.

OFFICE OF THE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER
THE UNIVERSITY OF TEXAS AT AUSTIN

P.O. Box 8179 • Austin, Texas 78713-8179
(512) 471-1422 • FAX (512) 471-7742

August 2, 2005

INTERAGENCY MAIL

Mr. John Keel, CPA
State Auditor
Robert E. Johnson Building
1501 North Congress, Suite 4.224
Agency Code: 308

Dear Mr. Keel:

We have reviewed the draft audit report titled "*The Reasonableness and Results of Tuition Increases Implemented by Four Higher Education Institutions in the 2004-2005 Biennium.*" We thank you and your colleagues for the good work on this report. Your colleagues were professional and courteous. We appreciate your consideration of our preliminary comments offered on the first draft report. On behalf of The University of Texas at Austin, we offer the following comments regarding the final report.

Recommendation #1 (Page 2)
We agree that accountability can be enhanced by the development of more detailed standards for the classification of revenues and expenditures. As noted by the SAO in its report, there are fundamental differences that prevent meaningful comparisons between or among institutions of higher education. Institutions differ greatly in size, scope of operations and availability of multiple funding sources. Institutions should be encouraged to identify comparative institutions and make periodic logical comparisons. The University of Texas at Austin has established a comparative group with which it regularly compares itself for the purpose of assessing its performance.

Recommendation #2 (Page 2)
We agree that there are opportunities to enhance institutional accountability for the use of tuition monies resulting from an increase in tuition. Because institutions of higher education have multiple funding sources, requiring institutions to account for tuition increases by cohort may not enhance institutional accountability. We believe that accountability can best be enhanced by requiring institutions to provide periodic public analysis that compares the goals on which a tuition increase was based to the actual results delivered. This analysis might also incorporate the State's goals contained in "Closing the Gaps."

Recommendation #3 (Page 4)
We agree that the legislature should work with the Texas Higher Education Coordinating Board and institutions to more precisely capture legislative intent regarding the distribution of student financial aid from required set-aside funds. The University of

Mr. John Keel, CPA
August 2, 2005
Page 2 of 3

Texas at Austin volunteers to participate in such an effort. Current legislation requires the determination of "unmet tuition need" for the purpose of awarding set-aside financial aid. This determination can only be made after all possible sources of other non-set-aside financial aid are known unless it is to be based on estimates. We do not recommend using estimates because it can result in making awards to students who ultimately prove to be ineligible for financial aid. On the other hand, using actual data would require a university to delay making the award of set-aside financial aid until after the beginning of a semester. A delay would cause significant hardship to students and families who need to plan financially. It would also be inconsistent with commonly accepted national practices for the award of financial aid. It is for these reasons that UT Austin did not perform the statutorily-required calculation as noted by the SAO. Rather, we believe that the Legislature intended for the set-aside financial aid to be awarded to students on a timetable in accordance with the commonly accepted national practices for the award of financial aid, which invalidated the need for such a calculation.

Additionally, we believe that the term "priority" as used in the legislation was meant to highlight that the definition of a needy student should give consideration to students coming from middle income families. We do not believe that the term was intended to dictate a new methodology to award the set-aside funds that was different from commonly accepted methodologies. At UT Austin the parameters for determining financial need and awarding the set-aside monies were increased from the traditional annual family income cutoff of $40,000 to $80,000. This was done to provide additional grant assistance to more students from middle income families. In 2003, the median household income in Texas was $52,182 (four person family) (http://www.census.gov/hhes/www/income/medincsizeandstate.html). By definition, then, half of the Texas households earned less than this sum, so that $52,000 is a reasonable proxy for "middle income." However, by including families up to $80,000, we estimate that we accounted for the bottom seventy-five percent of all Texas families. However "middle income" is defined, the bottom three-fourths of the Texas population should count as middle income. Had UT Austin applied the definition of "priority" as it was used in the course of audit testing, it would have made financial aid awards to students with family incomes of up to $200,000 principally funded by reducing the amounts that were otherwise awarded to students of more modest financial means. We do not believe that the Legislature intended that financial aid awards be reduced for more needy students in order to provide grant funds for students from families with six figure incomes. We believe that the award of the financial aid set-aside made by UT Austin was appropriate and was made in accordance with the intentions of the Texas Legislature.

Auditor's Follow-Up Comment

House Bill 3015 required that priority be given to students (1) with financial need and (2) with unmet need according to the bill's definition. Because students from families with incomes as high as $200,000 can and do qualify for financial need according to the federal and Texas Higher Education Coordinating Board definitions, these students' unmet need according to House Bill 3015 would need to be calculated in order to determine whether they qualified for priority in awarding financial aid from the funds set aside from increased tuition revenue. The federal government takes several factors into account in identifying students with financial need, in addition to their family income, such as the number of dependents in the household, number of people in the household attending college, and age of the oldest parent.

(The University of Texas at Austin's Management's Response, page 2, continued)

Recommendation #4 (Page 5)
We agree that a periodic, comprehensive review of balances should be made and the results considered in making decisions regarding whether to increase tuition and/or fees. As noted by the SAO, The University of Texas at Austin already has procedures intended to ensure that this happens. We believe that our procedures have been effective in ensuring that available balances are incorporated into the regular budget process and are therefore considered in the tuition setting process.

Appendix

We additionally offer the following comments regarding the attachments.

Table 2 – The University of Texas at Austin would emphasize that when measured based on tuition and fees, (i.e., components of costs it can influence or control), UT Austin has the second lowest Average Tuition and Mandatory Fees in Academic Year 2004-2005 amongst the four institutions presented. In contrast, UT Austin has the second highest Average Cost of Attendance of those presented due to the higher cost of living in Austin as compared to College Station and Lubbock. Cost of living is not controllable by the University or an institution.

Table 3 – The University of Texas at Austin would emphasize that the fiscal year 2005 expenditures presented in the "Actual" column are for a partial year yet the revenue from the tuition increase is for a full year. By the end of the fiscal year, the University will have spent the entire amount of the revenue from tuition increase.

Part 4: Did Audited Institutions Award Student Financial Aid from Revenue from Increased Tuition as Required? - The University of Texas at Austin's awarding policy and amount of set-aside went beyond what was required by HB3015. We estimate that our parameters for awarding the set-aside accounted for about seventy-five percent of all Texas families. The awarding policy gave consideration to students that received minimal or no grant support. National studies, as well as institutional data, verify that middle income families, particularly those families making more than $80,000 a year, are not suffering from lack of access or opportunity to enroll in higher education. The University's awarding policy responded specifically to the national, state and institutional data available, as well as, being mindful of the Texas Higher Education Coordinating Board's "Closing the Gaps" initiative. Of particular concern are those students coming from needy families.

We appreciate the opportunity to comment on this report. We are available to provide any clarification to these responses or to answer any questions.

Sincerely,

Kevin P. Hegarty
Vice President and Chief Financial Officer

c: Chancellor Mark G. Yudof, The University of Texas System
President Larry R. Faulkner, The University of Texas at Austin

TEXAS A&M UNIVERSITY

1246 TAMU
College Station, Texas 77843-1246
(979) 845-2217 FAX (979) 845-5027
E-Mail: PRESIDENT@TAMU.EDU

August 2, 2005

Office of the President
Robert M. Gates

Mr. John Keel, CPA
State Auditor
P.O Box 12067
Austin, TX 78711-2067

Dear Mr. Keel:

Comments related to the audit report titled "The Reasonableness and Results of Tuition Increases Implemented by Four Higher Education Institutions in the 2004-2005 Biennium" are attached. Texas A&M University appreciates the working relationship and open communication established by your office during the audit, and the efforts of your staff to understand the approach the University took in determining tuition increases.

As is noted in more detail in the comments attached, Texas A&M recognizes the increasing burden of the cost of higher education placed on students and their families. Accordingly, each year the University performs a detailed review of priorities weighed against other funding options. Only after careful consideration of these factors, including legislative appropriations, will a tuition increase be implemented. As is noted in Table 1 of the Attachment to the audit report, Texas A&M had the lowest percentage increase in tuition and mandatory fees over the 2004-2005 biennium of the four institutions audited.

Additionally, Texas A&M has set aside funds for financial aid above the amount required. The University strives to maximize the use of funds set aside from increased tuition to best meet the needs of our students and achieve State and University priorities.

Mr. John Keel
August 2, 2005
Page 2

Thank you for the opportunity to comment on the statements and recommendations included in the audit report. As always, I and my staff are available for further discussion and to answer any questions you may have.

Sincerely,

Robert M. Gates

Attachment

cc: Dr. Robert D. McTeer, Chancellor, Texas A&M University System
Dr. David B. Prior, Executive Vice President and Provost
Ms. K. Sue Redman, Senior Vice President and Chief Financial Officer

State Auditor's Office Report on The Reasonableness and Results of Tuition Increases Implemented by Four Higher Education Institutions in the 2004-2005 Biennium

Comments on Statements and Recommendations

SAO's Recommendations:

The Legislature may consider requiring institutions to develop and implement more detailed standards for the classification of reported revenues and expenditures. Such standards could result in institutions and the Texas Higher Education Coordinating Board (Coordinating Board) producing the detailed information necessary to provide reports that are more accessible and comparable across the State's institutions of higher education.

SAO's Recommendations:

To hold institutions accountable for the receipt and expenditures of incremental tuition revenue, the Legislature would need to require public institutions to account separately for the uses of that revenue. An alternative approach would be for the Legislature to consider using outcome measures compared to the stated reasons for increases in tuition as a way to ensure accountability for such increases.

TAMU's Response:

Approach to Tuition Increase Determination

TAMU is very cognizant of the increasing burden of higher education placed on students and their families. In fact, and as noted in the attachment to the audit report, administrative, college, and library expenditures were reduced at TAMU by $20.4 million (or 6.6%) prior to determining the amount of tuition increase for the 2003-2004 academic year.

In preparing our annual budgets and determining amounts required for tuition increases, TAMU undertook a detailed review process of priorities and incremental funding sources. The University then reallocated resources and implemented efficiencies before calculating the amount needed from increased tuition. Tuition increases were an output of the budget process, and were limited in amount to the difference in incremental expenditures and incremental funding. While expenditures weren't designed to be traced to the specific dollars generated by tuition increases, actual financial results versus budget can be examined to assess reasonableness of tuition increases.

Compliance with Laws and Other Authoritative Guidelines

Texas A&M University's (TAMU) accounting methods are in accordance with applicable regulatory requirements and accounting standards, including: Governmental Accounting

Standards Board (GASB) standards, Texas state law, and the Texas Higher Education Coordinating Board (THECB) guidelines and requirements.

TAMU segregates budgeted and actual expenditures related to various fund groups in accordance with the standards, laws, and guidance noted above. Because the revenues received from tuition increases were not adequate to fund the initiatives and priorities established, funds from additional sources were used to fill the shortfalls. Funds are only combined to the extent permitted and to maximize the efficiencies in financing University and State priorities, initiatives, and objectives.

Accountability

Further restrictions on the use of funds and/or requirements to track expenditures would reduce efficiencies and increase administrative costs at the University because of the complexity of the various funding sources and expenditures made by Research Universities. TAMU believes that the appropriate review for accountability of the use of increased tuition is in outcomes rather than the tracking of individual revenue and expenditure line items. Many accountability measures are already addressed in the Higher Education Accountability System, of which TAMU is included.

Should additional monitoring of expenditures and funds related to tuition increases be deemed necessary by the Legislature, TAMU proposes to coordinate efforts with the THECB and our peer research institution, as grouped according to the Higher Education Accountability System. Currently, TAMU and the University of Texas are designated as Research Universities in the Higher Education Accountability System. The other two institutions included in this SAO Report are categorized as "Emerging Research Universities" and may have different levels of complexity and considerations as do other universities in the State.

SAO's Recommendations:

To address these challenges, the Legislature should consider (1) capturing more precisely legislative intent regarding the distribution of student financial aid from the required set-aside funds and (2) providing guidance on implementation of that intent.

TAMU's Response:

The THECB is currently authorized to set guidelines for state institutions of higher education, including those related to student financial aid. Texas A&M University awarded the HB3015 deregulated tuition set-asides for financial aid as scholarships and grants in accordance with the established definition of financial need used by the THECB, which mirrors the federal definition of financial need. Each year, the Department of Student Financial Aid reviews the available funds from various sources (federal, state, and institution) to determine the best way to meet the needs of our students and the priorities of the institution and state while working within the restrictions placed on those funds. The packaging of funds is conducted in a manner to best meet the needs of students at all income levels. It should be noted that the greater the number of restrictions on funds and the less flexibility, the more difficult it is to accomplish these two goals - meeting student needs and meeting institutional and state priorities.

With regard to the priority definition, TAMU interpreted priority to mean consideration for aid, but considered that priority in the context of its overall packaging of financial aid. The packaging of financial aid takes into account how to assist as many students as possible while minimizing unmet financial need for all students. However, it should be noted that the timing of financial aid decisions and the receipt of additional scholarships and grants after the original package is made can make large differences in the final analysis after that aid is actually disbursed to the student.

Texas institutions of higher education are subject to a number of metrics, which are tracked and reported on allowing for assessment of performance and increased accountability to deliver on State priorities. TAMU's efforts are focused on improving performance related to these metrics and the University seeks to maximize the use of funds to do so. If desired by the Legislature, TAMU will work with the THECB to develop, track, and report on additional performance metrics. However, further restrictions limiting flexibility, including those impacting policies related to student financial aid, may increase administrative costs and negatively impact the University's ability to impact existing performance metrics and State priorities.

It is also important to note that TAMU's actual set asides of financial aid from tuition for the period audited (Spring 2004, Fall 2004, and Spring 2005) exceeded the minimum required set asides. The minimum set aside required of TAMU for this time period was \$5.7 million. Another \$5 million on top of this amount was set aside for financial aid.

SAO's Recommendations:

To ensure that institutions consider the results of their fund balance reviews in making decisions regarding tuition rates, the Legislature would need to require them to conduct and document their reviews of fund balances and certify their inclusion of these reviews in their tuition planning processes.

TAMU's Response:

As noted in comments on other statements above, TAMU seeks to limit the amount of tuition increases through a detailed review of priorities and incremental funding sources. Fund balances are examined on a periodic basis as part of this process. In the event available funds are identified, amounts are considered as funding sources for future years' budgets – as was noted in the specific examples mentioned in the attachment to the audit report.

TAMU constantly and consistently strives to improve efficiencies, effectiveness, and controls across the University. TAMU understands the importance of fund balance reviews and will continue to focus efforts on assessing fund balance levels and factoring results of these reviews into fiscal decisions and budgets.

5

State Auditor's Office Report on The Reasonableness and Results of Tuition Increases Implemented by Four Higher Education Institutions in the 2004-2005 Biennium

Comments on Tables and Figures

Comments on Table 18:

This table understates TAMU's total commitment to financial aid by approximately $5 million. It is our understanding that the auditors did not include this additional amount as it could not be directly tied to deregulated tuition.

Comments on Table 19:

The differing amounts between each institution in the number of students who received the funds generated by the mandated set-asides reflect differences in how those funds were used. Texas A&M University awarded larger dollar amounts to meet specific needs – both student and institutional. Other institutions approached the use of these funds differently (for example by providing awards to more students but at lower dollar amounts per student) to meet their specific needs. In addition, these numbers only reflect the mandated set-asides and do not reflect the awards from the additional funds allocated for financial aid as referenced in the comments on Table 18 above.

TEXAS TECH UNIVERSITY
Office of the President
Box 42005
Lubbock, TX 79409-2005
(806) 742-2121
FAX (806) 742-2138

August 31, 2005

Mr. John Keel, CPA
State Auditor
P. O. Box 12067
Austin, Texas 78711-2067

RE: TTU Management Response to Audit of Tuition Increases

Dear Mr. Keel,

Texas Tech University would like to thank your office for their willingness to maintain an open dialogue throughout the audit. The ongoing communication has benefited all participants and provided a productive and positive environment.

With regard to the first recommendation, higher education throughout Texas and the nation is guided by the use of national standards, policy, and practices promulgated through the Governmental Accounting Standards Board (GASB) and the National Association of College and University Business Officers (NACUBO). Although each institution maintains an individual accounting system, following established standards and practices helps ensure proper reporting of revenue and expenditures and allows for needed comparisons among institutions. Currently, NACUBO and the Texas Association of State Senior College and University Business Officers (TASSCUBO) have ongoing efforts to address consistency in higher education financial reporting, which we support. We do not believe more rigid standards related to classification of revenues and expenditures are necessary.

Related to the second recommendation, the report acknowledges that although specifically accounting for incremental tuition was not required by House Bill 3015, Texas Tech did separately track the incremental tuition revenue and related expenditures in order to maintain the highest accountability to our constituents, particularly our students. The university has reviewed each tuition increase with the administration and the Board of Regents to ensure that the revenues were used for the identified areas of need.

Additionally, the Higher Education Coordinating Board and each board of regents approved the Higher Education Accountability System in Fall 2004 to provide consistent information for decision-making related to tuition deregulation as required in the statutes. The Texas Tech

An EEO/Affirmative Action Institution

Board of Regents has adopted the key measures from the Coordinating Board Accountability System to monitor the University's effectiveness in providing a quality education. Thus, Texas Tech believes present standards and processes, including the Coordinating Board Accountability System, ensure accountability.

The third recommendation focused on a number of challenges and whether there should be an action to clarify the distribution of student financial aid from the required set-aside funds. Texas Tech University acknowledges the complexity of awarding financial aid. The university believes the statute is clear that only students who have established financial need in accordance with the Coordinating Board rules are eligible for the financial assistance funded by designated tuition. If the Coordinating Board rules require changes to further clarify financial need for this program, Texas Tech would participate in the process. The majority of set-aside funds at Texas Tech were awarded to students who were prioritized according to those with greatest unmet need to fully fund tuition and fees with gift aid, including set-aside funds. The balance was awarded to students with unmet need based on standard practices utilized by the profession. Texas Tech believes its policies accomplish the Legislature's intent for this financial assistance.

Finally, Texas Tech possesses very limited available fund balances to consider as an ongoing resource to offset tuition increases as suggested in the final recommendation. We attempt to consider all resources when making allocation decisions; however, we agree that defining a process that contemplates the condition under which fund balances (including unbudgeted contingencies) will be used is worthwhile.

Thank you for the opportunity to respond to the findings and recommendations. Our staff is available for further discussions as you require.

Regards,

Jon Whitmore

Jon Whitmore
President

cc: Thomas Anderes, Senior Vice President for Administration and Finance
William Marcy, Provost/Senior Vice President for Academic Affairs
Martha Brown, Associate Vice Chancellor of Governmental Relations
Kimberly F. Turner, Director of Audit Services

UNIVERSITY OF HOUSTON SYSTEM
UNIVERSITY OF HOUSTON

JAY GOGUE
Chancellor, UH System
President, University of Houston

July 20, 2005

Mr. John Keel, CPA
State Auditor
P. O. Box 12067
Austin, Texas 78701

Dear Mr. Keel:

Thank you for the opportunity to provide comments in response to your report on tuition increases at selected higher education institutions. We appreciate the difficulty of this task.

In response to the recommendations included in the report, I offer the following observations:

The first two recommendations relate to accountability for the use of designated tuition. Legislative action is not necessary to provide guidance in accounting for and reporting revenues and expenditures. Any additional financial reporting requirements should be developed with consultation between universities and the Comptroller's office to ensure that the most effective and meaningful information is available.

In response to the comments on financial aid, the University of Houston acknowledges the report's assessment of the difficulty in implementing the requirements of the Act. The University is continuously reviewing its financial aid processes in efforts to improve service and ensure compliance with all applicable statutes and policies. Since the challenges to the implementation of the prioritization requirements and the administration of the awards are largely procedural and given the nature of these challenges, it is appropriate to work with the other Texas universities and the Texas Higher Education Coordinating Board to reconcile these prioritization requirements with standard practices in the financial aid profession in accordance with state and federal laws.

The last recommendation relates to legislative requirements for fund balance reviews. Effective management and utilization of fund balances is a core management responsibility within our institution and an integral part of our annual budget development process. We utilized available fund balances to limit tuition increases in the period reviewed in this report. Statutory requirements for fund balance reviews at the University of Houston would not provide any additional benefit to our students or the State.

Thank you again for the opportunity to comment on the report. Please let me know if I can provide assistance as you complete this difficult task.

Sincerely,

Jay Gogue

JG/jm

212 E Cullen Building ■ Houston, Texas 77204-2018 ■ (713) 743-8820 Fax: (713) 743-8837 ■ E-mail: jgogue@uh.edu