

**MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES**

Agenda Item Summary Sheet

Committee: Finance and Facilities

Date of Meeting: January 17, 2012

Agenda Item: FY2011 and FY2010 Audited Financial Statements

Proposed Policy Change Approvals Required by Policy Other Approvals Monitoring

Information

Cite policy requirement, or explain why item is on the Board agenda: The purpose of this Board report is to present to the Finance committee of the Board of Trustees the audited financial report for the Minnesota State Colleges and Universities for the year ending June 30th, 2011 and 2010 and the results of individual institutions financial statement audits.

Scheduled Presenter(s): Laura M. King, Vice Chancellor - Chief Financial Officer
Colin Dougherty, Associate Vice Chancellor for Finance

Outline of Key Points/Policy Issues: The system-wide audit, revenue fund audit, and the thirteen individual college and university audits, received unqualified opinion letters from the respective audit firms. In addition, there were no reported material weaknesses or significant deficiencies in internal control. LarsonAllen LLP remarked this is a notable accomplishment. The opinion letters provide the Board and other users of the financial statements with assurance that the information is accurate and reliable in all material respects.

Fiscal year 2011 operating results yielded improvement in financial position at June 30, 2011, with a \$75.6 million net operating revenue surplus, compared to a prior year net operating revenue surplus of \$68.4 million.

Background Information: The financial statements were prepared by the Finance Division of the system office with the assistance of the campus Finance departments and have been audited by the firm of LarsonAllen LLP.

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**BOARD OF TRUSTEES
MINNESOTA STATE COLLEGES AND UNIVERSITIES
*INFORMATION ITEM***

FY2011 and FY2010 Audited Financial Statements

BACKGROUND

The purpose of this Board report is to present to the Finance and Facilities committee of the Board of Trustees the audited, consolidated financial statements for the Minnesota State Colleges and Universities for the years ending June 30, 2011 and 2010. These financial statements were prepared by the Finance division of the system office with the assistance of the campus Finance departments and have been audited by the firm of LarsonAllen LLP. This is the second year of a three year contract with LarsonAllen LLP as the system auditor. These statements were presented to the Audit Committee by the Finance division and LarsonAllen LLP, at the November 15, 2011 Audit Committee meeting.

AUDIT RESULTS

The system-wide audit, revenue fund audit, and the thirteen individual college and university audits, received unqualified opinion letters from the respective audit firms. In addition, there were no reported material weaknesses or significant deficiencies in internal control. LarsonAllen LLP remarked this is a notable accomplishment- it is a commendable achievement that no significant deficiencies were identified throughout the fiscal years 2011 and 2010 audit processes. The opinion letters provide the Board and other users of the financial statements with assurance that the information is accurate and reliable in all material respects.

The three external audit firms, LarsonAllen LLP, Kern DeWenter Viere, Ltd., and Baker Tilly Virchow Krause, LLP presented their respective results of audits, including audit opinions, internal control matters and other required communications at the November 15, 2011 Audit Committee meeting.

The Revenue Fund and thirteen individual college and university financial statements have been incorporated into the consolidated system wide financial statements along with the financial statements of the unaudited colleges. The Audit Committee members spent considerable individual time reviewing the various annual financial reports prior to the formal meeting. The two hour formal Audit Committee meeting generated good discussion based on Trustees' questions. The Audit Committee recommended release of the audited statements, a motion that was approved by the full Board of Trustees at the December 2011 meeting.

All audited financial reports may be viewed on the system's website at:
<http://www.finance.mnscu.edu/accounting/financialstatements/index.html>

INFORMATION

The system-wide financial report for fiscal years 2011 and 2010 is presented in accordance with Statement No. 35 *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities* as established by the Governmental Accounting Standards Board (GASB). The system's financial information is presented in one column form as a "Business Type Activity". The resources are still governed by the governmental fund based principles and continue to be accounted for in the general, special revenue, enterprise, agency, and revenue funds. Fund level information can be found in the financial statement supplemental schedules contained in a separate report (unaudited) titled "*Supplement to the Annual Financial Report for the year ended June 30, 2011.*" This supplemental report also contains financial statements for each college and university.

All university foundations plus the Century College Foundation and Fergus Area College Foundation are separately included in the related institutions' financial reports and the system's financial report. Reporting standards require the inclusion of component entities if found to be "significant" to the primary organization. The foundations and their auditors are very cooperative in adjusting their audit schedules in order to conform to the system's financial reporting audit schedule.

Summary of Financial Results

Fiscal year 2011 operating results yielded improvement in financial position at June 30, 2011, with a \$75.6 million net operating revenue surplus, compared to a prior year net operating revenue surplus of \$68.4 million.

- Net assets increased \$146.3 million or 8.5 percent; most of the increase was due to fiscal year 2010 capital appropriation revenue of \$65.5 million that funded capital asset investment, preservation and replacement.
- Income before other revenues, expenses, gains or losses, also termed "net operating revenue", increased from a surplus of \$68.4 million in fiscal year 2010 to a surplus of \$75.6 million in fiscal year 2011. This net operating revenue surplus is the net of \$1,979.6 million of operating and non-operating revenues less \$1,904 million of operating and non-operating expenses.
- Capital appropriation revenue of \$65.5 million plus other capital asset related revenue combined with the \$75.6 million net operating revenue surplus and generated a change in net assets of \$146.3 million, a slight decrease from the \$179.6 million change in net assets generated in fiscal year 2010.

Consolidated Statements of Net Assets

The primary driver of change within the Statements of Net Assets between June 30, 2011 and 2010 is capital asset development and renewal activity related to the system's 26 million plus square feet of academic and administrative buildings.

- New construction in progress of \$140.6 million was the primary factor increasing the capital assets balance, net of depreciation, by \$97.1 million.
- Capital asset financing came primarily from \$65.5 million of capital appropriation and \$150.8 million of new long-term debt.
- Net assets (e.g., net worth) increased \$146.3 million including a \$41.7 million increase in net assets invested in capital assets, net of related debt.

Consolidated Statements of Revenues, Expenses and Changes in Net Assets

Fiscal year 2011 operating expenses of \$1,867.4 million averaged \$5.1 million per day when divided by 365 days. Looking at the operating expense number in relation to liquid assets, the system's \$798.5 million of unrestricted cash, and equivalents plus unrestricted investments would be adequate to cover approximately 5.1 months of expenses, an improvement of 0.5 months from fiscal year 2010.

- Revenue sources funding operations included \$613.4 million of state appropriation; \$835.3 million of student payments, net of scholarship allowance; \$485.7 million of federal and state grants; and \$45.2 million of other revenue.
- Expenses supporting operations included \$1,249.3 million of compensation, \$218.8 million of purchased services (utilities, enterprise and other IT support, etc.), \$164.3 million of supplies, \$97.3 million of depreciation and other expenses of \$174.3 million.

TRENDS IN FINANCIAL AID

In fiscal year 2011, there was significant growth in financial aid awards to Minnesota State Colleges and Universities students. Total dollars of financial aid reached \$1.3 billion, an increase of \$.13 billion or 11 percent, compared to fiscal year 2010. Additional key metrics related to financial aid are:

- The number of financial aid recipients grew by 6,000, or 4 percent, to more than 172,000 students, during this same period.
- Fully 62 percent of credit students now receive financial aid, up from 60 percent in 2010, and 56 percent in 2009.
- Grants were received by 42 percent of students in 2011.

- Grant awards increased by \$41 million, or 11 percent, most of which was increases in federal Pell grants.
- Student borrowing increased by \$88 million, or 12 percent, most of which was increases in federal loans.
- The number of students that borrowed increased by almost 7,000, or 7 percent, with 42 percent of students borrowing in 2011.
- The average award for all types and sources of aid increased by 7 percent, from \$7,274 in 2010 to \$7,781 in 2011.
- Compared to 2003, total financial aid awards increased 151 percent, from \$533 million to \$1.3 billion in 2011.
- This growth came from both loans and grants, with approximately 2/3 coming in the form of loans and just under 1/3 coming in the form of grants.
- The number of financial aid recipients increased by 48 percent while total system headcount enrollment grew by 17% since 2003.
- The total amount of borrowing increased by 179 percent from \$301 million to \$838 million since 2003.
- The average loan from all sources increased by 60 percent from \$4,441 to \$7,126 since 2003.
- The average award for all types and sources of aid increased by 76 percent, from \$4,433 in 2003 to \$7,781 in 2011.

These trends represent a growing dependence by our students on loans and grants to fund their education. In turn, these trends represent a growing dependence by Minnesota State Colleges and Universities on financial aid as a means to achieve its mission to enable the people of Minnesota to succeed by providing the most accessible, highest value education in the nation.

**Measuring, Monitoring and Improving Financial Health:
Composite Financial Index (CFI) and Financial Health and Compliance Indicators**

The Composite Financial Index calculation uses four financial ratios and assigns a specific weighting to each factor in computing a single, composite measure of financial health. This CFI calculation methodology is also used by the Higher Learning Commission as a gauge of member institutions' financial health. Without detailing the actual calculation methodology,

financial ratio values are converted into strength factors which in turn are weighted to allow summing of the four components into a single, composite value.

Institutions may have differing values across the four component ratios but still have equivalent overall financial health as indicated by similar composite scores. This approach allows easy comparisons of relative financial health across different institutions. Looking at the composite scores, *Strategic Financial Analysis for Higher Education* suggests a composite value of 1.0 is equivalent to very little financial health, in the for-profit world it could perhaps be viewed as a “going-concern” threshold value, while a composite value of 3.0 is considered to signify relatively strong financial health, an organization with moderate capacity to deal with adversity or invest in innovation and opportunity. CFI scores greater than 3.0 represent increasingly stronger financial health.

November’s Audit Committee meeting included a high-level discussion of CFI, and the System’s Annual Financial Report for the Years Ended June 30, 2011 and 2010 included much of the CFI information that follows within the Management Discussion and Analysis.

How does the System’s financial health compare to other public institutions?

The FY2010 values in the Composite Financial Index (CFI) Comparisons in the following table are computed from ratio values contained in *Moody’s Fiscal Year 2010 Public College and University Medians* report and as such represent median values for 220 public colleges and universities rated (in whole or in part) within Moody’s public college and university portfolio. Fiscal year 2011 public college and university financial data is not available as yet. Rated components range from large state higher education systems to small public colleges and universities.

The letter-based credit rating designations in the CFI comparison table below are defined and used by Moody’s Investors Services. All ratings denote creditworthiness relative to other U.S. municipal or tax-exempt issuers or issues. The relative credit worthiness is: Aaa = highest quality; minimal credit risk, Aa = high quality; very low credit risk, A = upper medium grade; low credit risk.

Required calculations have been made by the system using four specific Moody’s median financial ratio values for each rating category and for the population as a whole. This information should only be used as an approximate indicator of the system’s financial health relative to the financial health of other public colleges and universities. The system’s individual colleges and universities show a similar range of composite values.

Financial Performance Measure										
Financial Performance Measure	FY11 System & Revenue Fund		Moody's 2010 Public College/University medians – Converted to Weighted Values and Composite Financial Index (CFI)							
	System	Revenue Fund only	All	Aaa	Aa1	Aa2	Aa3	A1	A2	A3
Primary Reserve	0.83	2.33	1.00	2.09	1.66	1.34	1.20	1.03	0.83	0.41
Viability	0.84	0.26	0.65	1.55	1.16	0.91	0.70	0.55	0.31	0.22
Net Operating Revenue	0.32	1.00	0.28	0.42	0.35	0.29	0.20	0.34	0.34	(0.18)
Return on Net Assets	0.92	0.89	0.78	1.01	.85	0.75	0.69	0.80	0.81	(0.67)
CFI	2.91	4.48	2.81	5.07	4.02	3.29	2.78	2.72	2.29	1.13
	The shaded cells link system values to the closest value(s) within a credit rating category									
	<ul style="list-style-type: none"> • The system ratios include the General Funds, Revenue Funds, Special Revenue Funds, Enterprise Funds, Agency Funds, and 9 Foundations deemed to be material. • Consistent with Moody's underlying ratios, the system's individual and composite (CFI) values include component units as reported in the Consolidated Financial Statement. Component units increased CFI from 2.70 to 2.91 due primarily to the foundations' collective realized and unrealized gains on investment. See <i>Minnesota State Colleges' and Universities' Foundations Statements of Activities</i>. • Moody's data includes 220 separate organizations. 									

Summary Ratios for FY2011 and FY2010

The system-wide financial ratios and other measures presented below are generally consistent with prior years' presentations. The focus this year is on the four financial ratios used in computing CFI. The "National Median" data is taken from *Moody's Fiscal Year 2010 Public College and University Medians* report. All system ratios are computed using financial data taken from the accrual financial statements. *Note: Higher values are deemed better for all ratios presented.* The *Supplement to the Annual Financial Report* may be examined to view individual college and university financial statements (<http://www.finance.mnscu.edu/accounting/financialstatements/yearendstatements/index.html>).

The fiscal year 2011 CFI of 2.91 went down compared to 2010's CFI of 3.25. These ratios represent Moody's ratings of Aaa to Aa1 for 2011, consistent with fiscal year 2010 ratio rating representation.

The following table provides reference benchmarks for individual components of the CFI for achieving a total CFI score of 3.0, a sign of good financial position but with additional room for improvement.

	<u>Weight</u>	<u>Benchmark</u>	<u>System</u>	<u>2 Yr</u>	<u>4 Yr</u>
Primary Reserve	35%	1.05	0.83	0.71	0.71
Viability	35%	1.05	0.84	1.13	0.52
Net Operating Revenue	10%	0.30	0.32	0.26	0.32
Return on Net Assets	<u>20%</u>	<u>0.60</u>	<u>0.92</u>	<u>1.10</u>	<u>0.57</u>
Composite Financial Index (CFI)	100%	3.0	2.91	3.20	2.12

Ratio Variability across Colleges and Universities

There is considerable variability in individual CFI financial ratio values across the 32 colleges and universities. The following tables, which exclude foundations, highlight the broad range in the results:

	<u>High</u>	<u>Low</u>	<u>Median</u>
Primary Reserve – <i>resource availability</i>	1.34	0.36	0.60
Viability – <i>debt coverage</i>	3.50	0.30	0.95
Net Operating Revenue – <i>surplus or deficit</i>	0.69	(0.40)	0.32
Return on Net Assets – <i>asset stewardship</i>	<u>2.00</u>	<u>(0.43)</u>	<u>1.28</u>
Composite Financial Index (CFI)	6.69	0.83	2.72

Midpoint of Quartiles	<u>1st</u>	<u>2nd</u>	<u>3rd</u>	<u>4th</u>
Primary Reserve – <i>resource availability</i>	1.09	0.70	0.53	0.41
Viability – <i>debt coverage</i>	2.60	1.34	0.77	0.46
Net Operating Revenue – <i>surplus or deficit</i>	0.55	0.35	0.21	(0.15)
Return on Net Assets – <i>asset stewardship</i>	1.76	1.08	0.63	0.02
Composite Financial Index (CFI)	5.48	3.36	2.38	1.42

Other Financial Measures

There are additional financial metrics which are used to measure, monitor, and improve the financial condition of each college and university.

The Board required reserve ratio below compares general fund cash-basis operating revenues to that portion of the general fund’s end-of-year cash balance that has been designated as a special reserve amount. The system-wide figure of 6 percent for fiscal year 2011 represents a reserve balance of \$91.2 million, an increase of 12.5 percentage points, or \$10.2 million, from fiscal year 2010.

In fiscal year 2011, 4 of the system’s 32 colleges and universities generated negative net operating revenues using a generally accepted accounting principles measurement; this compares to 6 colleges and universities in fiscal year 2010. Of the 4 colleges and universities with negative net operating revenue in fiscal year 2011, 2 also had negative net operating revenue in fiscal years 2010 and 2009. Ongoing operating deficits negatively impact the ability of these 2 institutions to maintain normal operations under adverse economic circumstances and to implement new strategic initiatives. Negative unrestricted net assets generally indicate a college or university has experienced ongoing operating deficits. A Board reserve at less than 3 percent can also be an indicator of poor financial condition.

	<u>FY2011</u>		<u>FY2010</u>		<u>FY2009</u>	
	#	%	#	%	#	%
Net operating revenue loss*	4	13%	6	19%	15	47%
Negative unrestricted net assets	0	0%	0	0%	1	3%
Board reserves below 3%	0	0%	1	3%	2	6%

* As shown in financial statements on line titled “Income (loss) before other revenues, expenses, gains, or losses.”

Are we balanced right? Should we be taking on more risks? Should we be even more prudent with respect to the stewardship of our resources?

The Audit Committee presentation of these results in November 2011 prompted members to ask the auditors and the staff to respond to the above questions. The system auditor responded in part;

The increased (strengthening) movement in the CFI as well as the pyramid of financial reporting shows (the system) moving into more advanced capability, ... the more sophisticated your financial management process is and the more distinct the quality, the system can run a little closer to the edge because it’s more in control.(However) the system is certainly not at the point where it has too much or is too financially stable, because state shutdowns, dramatic changes in student demographics and so many other things can happen. So I would encourage ...slowly moving the CFI up a bit would be advisable. What the system has already accomplished is very solid and positive financially from the financial reporting process, but continued moderate improvement is recommended.

Vice Chancellor King responded, in part:

... we really have nothing but downside risk in front of us. We have state appropriation exposure, ...downward pressure on revenue, federal Pell debate which could have a catastrophic impact on us from a student affordability standpoint. And we learned from the state shutdown that we have few degrees of freedom from an operating environment standpoint. I don’t see the upside that gives

us the freedom to not be as conservative as the Board has been, and as strongly supportive of improving these ratios, as this Board had been. ...I would like to see the system-wide (CFI) number go up, because it is a large number covering a lot of volatility. And there is some real risk inside that number on a school by school basis that gets shielded when we do it on a composite level.

Chancellor Rosenstone summarized the discussion in the following manner;

I am hearing a sense of not just proper balancing of the management of risk and the stewardship of resources vs. the opportunity cost of doing so, but if anything, an expression of caution. Both caution to ensure that we have the basis for the transformative innovations that have been suggested, but also we have the base to protect the quality of our academic program in the light of this very long list of risks we are facing and that we have a responsibility to manage forward.

In comparing the system wide CFI number to our peers, the system is either in the same range or higher than state universities and state systems of higher educations, while significantly lower than the private colleges and universities.

CONCLUSION

The Minnesota State Colleges and Universities system maintained a relatively strong financial position in fiscal year 2011, as measured by the \$75.6 million net operating revenue surplus and the \$146.3 million increase in net assets, despite a \$48.2 million reduction in state appropriation funding. This performance reflects the strong financial management exercised by the system's leadership team and the continued strong investment in capital assets. The leadership team continues to maintain its focus on aggressively managing costs to deliver efficient and effective services to our students. The current weak economy is providing both challenges and opportunities. The system experienced unprecedented enrollment in the last few years as more citizens pursued their education and job enhancing skills during these difficult economic times, however this trend is leveling off for the upcoming years. The system continues to remain dependent on the state's support in order to maintain affordability and access for students. The state's continued support is more critical now as colleges and universities educate Minnesota's workforce and fundamental participants of our state's economy.

Date Presented to the Board of Trustees: January 17, 2012