

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

Agenda Item Summary Sheet

Committee: Finance and Facilities Committee **Date of Meeting:** January 16, 2013

Agenda Item: FY2012 and FY2011 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 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, 2012 and 2011.

Scheduled Presenter(s): Laura M. King, Vice Chancellor – Chief Financial Officer
Denise Kirkeby, Direct of Financial Reporting

Outline of Key Points/Policy Issues:

The systemwide 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 and one reported significant deficiency in internal controls. 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.

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 CliftonLarsonAllen LLP. This is the third year of a four year contract with CliftonLarsonAllen LLP as the system auditor. These statements were presented to the Audit Committee by the Finance division and Clifton LarsonAllen LLP at the January 15, 2013 Audit Committee meeting.

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

FY2012 and FY2011 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, 2012 and 2011. 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 CliftonLarsonAllen LLP. This is the third year of a four year contract with CliftonLarsonAllen LLP. as the system auditor. These statements were presented to the Audit Committee by the Finance division and CliftonLarsonAllen LLP at the January 15, 2013 Audit Committee meeting.

AUDIT RESULTS

The systemwide 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 and one reported significant deficiency in internal controls. 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, CliftonLarsonAllen 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 January 15, 2013 Audit Committee meeting.

The Revenue Fund and thirteen individual college and university financial statements have been incorporated into the consolidated systemwide financial statements along with the financial statements of the unaudited colleges. The Audit Committee recommended release of the audited statements, a motion that will be presented to the full Board of Trustees at the January 16, 2013 meeting.

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

INFORMATION

The systemwide financial report for fiscal years 2012 and 2011 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, 2012.*” 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 2012 operating results yielded improvement in financial position at June 30, 2012, with a \$62.9 million net operating revenue surplus, compared to a prior year net operating revenue surplus of \$75.6 million.

- Net assets increased \$121.5 million or 6.5 percent; most of the increase was due to fiscal year 2012 capital appropriation revenue of \$56.4 million that funded capital asset investment, preservation and replacement.
- Income before other revenues, expenses, gains or losses, also termed “net operating revenue”, decreased from a surplus of \$75.6 million in fiscal year 2011 to a surplus of \$62.9 million in fiscal year 2012. This net operating revenue surplus is the net of \$1,879.2 million of operating and non-operating revenues less \$1,816.3 million of operating and non-operating expenses.
- Capital appropriation revenue of \$56.4 million plus other capital asset related revenue combined with the \$62.9 million net operating revenue surplus and generated a change in net assets of \$121.5 million, a slight decrease from the \$146.3 million change in net assets generated in fiscal year 2011.

Consolidated Statements of Net Assets

The primary driver of change within the Statements of Net Assets between June 30, 2012 and 2011 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 \$175.7 million was the primary factor increasing the capital assets balance, net of depreciation, by \$90.6 million.
- Capital asset financing came primarily from \$56.4 million of capital appropriation and \$22.5 million of new long-term debt.

- Net assets (e.g., net worth) increased \$121.5 million including a \$33.2 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 2012 operating expenses of \$1,782.5 million averaged \$4.9 million per day when divided by 366 days. Looking at the operating expense number in relation to liquid assets, the system's \$836.2 million of unrestricted cash and equivalents plus unrestricted investments would be adequate to cover approximately 5.6 months of expenses, an improvement of 0.5 months from fiscal year 2011.

- Revenue sources funding operations included \$551.3 million of state appropriation; \$831.5 million of student payments, net of scholarship allowance; \$443.5 million of federal and state grants; and \$52.8 million of other revenue.
- Expenses supporting operations included \$1,203.2 million of compensation, \$210.9 million of purchased services (utilities, enterprise and other IT support, etc.), \$149.1 million of supplies, \$104.1 million of depreciation and other expenses of \$149.0 million.

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.

January's Audit Committee meeting included a high-level discussion of CFI, and the System's Annual Financial Report for the Years Ended June 30, 2012 and 2011 included much of the CFI information that follows within the Management Discussion and Analysis section of the report.

Summary Ratios for FY2012 and FY2011

The systemwide 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. 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* is available to view individual college and university financial statements and can be located at:

<http://www.finance.mnscu.edu/accounting/financialstatements/yearendstatements/index.html>

The fiscal year 2012 CFI of 2.78 was down slightly compared to 2011’s CFI of 2.91.

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	0.98	0.82	0.92
Viability	35%	1.05	0.97	1.17	0.67
Net Operating Revenue	10%	0.30	0.23	0.13	0.38
Return on Net Assets	<u>20%</u>	<u>0.60</u>	<u>0.60</u>	<u>0.60</u>	<u>0.68</u>
Composite Financial Index (CFI)	100%	3.0	2.78	2.72	2.62

Ratio Variability across Colleges and Universities

There is considerable variability in individual 2012 CFI financial ratio values across the 31 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>	1.54	0.38	0.81
Viability – <i>debt coverage</i>	3.50	0.33	1.04
Net Operating Revenue – <i>surplus or deficit</i>	0.67	(0.38)	0.11
Return on Net Assets – <i>asset stewardship</i>	1.93	(0.15)	0.53
Composite Financial Index (CFI)	5.62	0.48	2.87

All four measures show wide ranges of ratios, both in operating terms (Primary Reserve and Net Operating Revenue ratios) and balance sheet terms (Viability and Return on Net Assets ratios). Capital investment rates and baseline capital assets and related depreciation requirements have significant impacts on these ratios.

Another perspective views the variability at mid points as a method for illustrating the diversion of the individual college and university ratios. The primary Reserve and Net Operating Revenue ratios and the relative narrow mid points illustrate the challenge colleges and universities face in managing difficult fiscal circumstances.

Midpoint of Quartiles	<u>1st</u>	<u>2nd</u>	<u>3rd</u>	<u>4th</u>
Primary Reserve – <i>resource availability</i>	1.27	0.89	0.68	0.47
Viability – <i>debt coverage</i>	2.78	1.41	0.85	0.54
Net Operating Revenue – <i>surplus or deficit</i>	0.50	0.21	0.05	(0.21)
Return on Net Assets – <i>asset stewardship</i>	<u>1.33</u>	<u>0.61</u>	<u>0.35</u>	<u>(0.02)</u>
Composite Financial Index (CFI)	4.66	3.17	2.32	1.18

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 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 systemwide figure of 6 percent for fiscal year 2012 represents a reserve balance of \$99.8 million, an increase of \$7.9 million, from fiscal year 2011 and is equivalent to approximately two payroll cycles.

In fiscal year 2012, 12 of the system’s 31 colleges and universities generated negative net operating revenues using a generally accepted accounting principles measurement; this compares to 4 colleges and universities in fiscal year 2011. Of the 12 colleges and universities with negative net operating revenue in fiscal year 2012, only one also had negative net operating revenue in fiscal years 2011 and 2010. The significant number of institutions reporting net operating losses is attributed principally to the use of fund balance as a part of a budget strategy. Ongoing operating deficits negatively impact the ability of an institution 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.

	FY2012		FY2011		FY2010	
	#	%	#	%	#	%
Net operating revenue loss*	12	39%	4	13%	6	19%
Negative unrestricted net assets	0	0%	0	0%	0	0%
Board reserves below 3%	0	0%	0	0%	1	3%

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

College and university financial performance is monitored by the Finance division on an ongoing basis. Monthly, quarterly, and biannual indicators are reported and discussed with the college/university leadership. Financial improvement plans are established where warranted and annual reporting to the chancellor occurs.

CONCLUSION

The Minnesota State Colleges and Universities system maintained a relatively strong financial position in fiscal year 2012 despite receiving a \$62.0 million state appropriation reduction. The system maintained a relatively strong financial position in fiscal year 2012, as measured by the \$63 million net operating revenue surplus and the \$121.5 million increase in net assets. The system continues to rely heavily on state operating appropriation support to implement new programs tailored to the needs of the state's workforce, to maintain ongoing operations, and to devise the innovative strategies necessary to successfully manage the future challenges presented by a weak economy and a constantly evolving higher education marketplace.

The state, national and global economies have experienced the impacts of a significant recession throughout fiscal year 2011. As on the occasion of past increases in the general unemployment rate, the system experienced corresponding increases in enrollment. Overall enrollment levels at the colleges and universities have decreased 2.8 percent, and increased 1.6 percent, and 8.1 percent year over year in 2012, 2011 and 2010. Enrollment forecasts in 2013 and 2014 are stable or slightly declining compared to 2012. It is expected that enrollment will once again moderate as the state's unemployment rate declines. The current 2012 enrollment forecast represent a 12.3 percent increase over 2006 and a 3 percent increase over 2010. The system's colleges and universities have aggressively managed class sizes, course offerings, and hours of operations in order to serve as many students as possible.

State appropriation revenue was reduced in the fiscal years 2009, 2010, 2011 and 2012 although reductions were somewhat offset with one-time federal stimulus funds totaling \$79.2 million in fiscal 2010 and 2011. System leadership has worked tirelessly to minimize tuition increases and the detrimental impact of cost cutting on the system's approximately 3,800 educational programs; both efforts are aimed squarely at limiting the negative impacts of state reductions on students.

The changes in the federal financial aid program, in concert with the state and national economic conditions, has resulted in a substantial increase in federal financial aid participation by the system's students over the past three years. Reliance on state and federal financial assistance by current and future students is a state and national concern as affordability competes with the withdrawal of state support for public higher education. Further, the increased personal debt burden of today's students threatens participation and completion rates.

The continuing success of the system depends on a partnership with the state of Minnesota and its citizens. Preservation of the high quality, broadly accessible system of colleges and universities now available across the state will require continuing support from the state. The system leadership is committed to a statewide partnership with government, industry and the community to add to the prosperity of Minnesota. The system will also continue its aggressive management of costs and services to ensure efficient, effective operations on behalf of current and future students. The partnership enables the provision of accessible,

high value, affordable higher education in accord with the economic and intellectual needs of the state. The state's continued support is critical to maintaining both affordability and access for students.

Date submitted to Board of Trustees: January 16, 2013