

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

Agenda Item Summary Sheet

Name: Finance and Facilities Committee

Date: January 28, 2015

Title: FY2014 and FY2013 Audited Financial Statements

Purpose (check one):

- | | | |
|---|---|---|
| <input type="checkbox"/> Proposed
New Policy or
Amendment to
Existing Policy | <input type="checkbox"/> Approvals
Required by
Policy | <input type="checkbox"/> Other
Approvals |
| <input type="checkbox"/> Monitoring /
Compliance | <input checked="" type="checkbox"/> Information | |

Brief Description:

The purpose of this report is to present to the Finance committee the audited, consolidated financial statements for the Minnesota State Colleges and Universities for the years ending June 30, 2014 and 2013. 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 first year of a three year contract with CliftonLarsonAllen, LLP as the system auditor. These statements were presented to the Audit committee by the Finance division and Clifton Larson Allen LLP, at the November 18, 2014 Audit committee meeting.

Scheduled Presenter(s):

Laura M. King, Vice Chancellor – CFO
Denise Kirkeby, Director – Financial Reporting

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

INFORMATION ITEM

FY2014 and FY2013 Audited Financial Statements

BACKGROUND

The purpose of this 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, 2014 and 2013. 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 first year of a three 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 November 18, 2014 Audit committee meeting.

AUDIT RESULTS

The MnSCU system audit, revenue fund audit, and the four college and university audits, received unmodified opinion letters from CliftonLarsonAllen LLP. In addition, there were no reported material weaknesses and no reported significant deficiencies in internal control. 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 external audit firm, CliftonLarsonAllen LLP, presented their results of the audits, including audit opinions, internal control matters and other required communications at the November 18, 2014 Audit committee meeting.

The revenue fund and the four 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 system's statements were, in turn, incorporated into the state of Minnesota Comprehensive Annual Financial Report and released to the public in December, 2014.

All audited financial reports are available on the system's website at:

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

INFORMATION

The MnSCU system financial report for FY2014 and FY2013 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. Each college and university’s financial statements are included in a separate report (unaudited) titled “*Supplement to the Annual Financial Report for the year ended June 30, 2014.*”

All university foundations are separately included in the related institution’s 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

FY2014 operating results yielded a decline in financial position at June 30, 2014, with a \$43.7 million net operating revenue deficit, compared to a prior year net operating revenue deficit of \$2.0 million.

- Net position increased \$16.0 million or 0.8 percent; most of the increase was due to FY2014 capital appropriation revenue of \$54.7 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 deficit of \$2.0 million in FY2013 to a deficit of \$43.7 million in FY2014. This net operating revenue deficit is the net of \$1,892.3 million of operating and non-operating revenues less \$1,936.0 million of operating and non-operating expenses.
- Capital appropriation revenue of \$54.7 million plus other capital asset related revenue combined with the \$43.7 million net operating revenue deficit and generated a change in net position of \$16.0 million, a decrease from the \$91.1 million change in net position generated in FY2013.

Statements of Net Position

The primary driver of change within the Statements of Net Position between June 30, 2014 and 2013 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 \$138.2 million was the primary factor increasing the capital assets balance, net of depreciation, by \$48.7 million.

- Capital asset financing came primarily from \$54.7 million of capital appropriation and \$28.3 million of new long-term debt.
- Net position (e.g., net worth) increased \$16.0 million, including a \$35.6 million increase in net position invested in capital assets, net of related debt.

Statements of Revenues, Expenses and Changes in Net Position

FY2014 operating expenses of \$1,902.4 million averaged \$5.2 million per day when divided by 365 days. Looking at the operating expense number in relation to liquid assets, the system's \$883.2 million of unrestricted cash and equivalents plus unrestricted investments would be adequate to cover approximately 5.9 months of expenses (excluding depreciation), a decline of 0.2 months from FY2013.

- Revenue sources funding operations included \$591.2 million of state appropriation; \$810.1 million of student payments, net of scholarship allowance; \$447.6 million of federal and state grants; and \$43.4 million of other revenue.
- Expenses supporting operations included \$1,296.9 million of compensation, \$234.0 million of purchased services (utilities, enterprise and other IT support, etc.), \$141.2 million of supplies, \$113.5 million of depreciation and other expenses of \$150.4 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.

The two current operating measures, return on net position and net operating revenue, demonstrate the level of return on net position and the extent to which operating revenues do or do not cover operating expenses, respectively. In FY2014 there was a revenue decrease as a result of sharper than forecast enrollment declines. At the same time, operating expenses increased due to the bargaining unit negotiated salary increases, the higher cost of insurance

premiums, and the lag in expense adjustments necessitated by the enrollment declines. The operating expense increases, coupled with the operating revenue decreases resulted in a reduction to both return on net position and net operating revenue ratios in FY2014.

The primary reserve and viability ratios measure an organization’s liquid net position that is available directly, or through additional borrowing, to cover emergency expenditures or finance investments in new innovations. Representing available liquidity or borrowing capacity, these measures are not dependent on current operating results in the short-term but rather reflect the long run financial strength of the organization. These measures are good indicators of financial health, and combined, are weighted 70 percent in the CFI calculation.

Although both ratios decreased slightly in FY2014 compared to FY2013, they remain at high enough levels, to help keep the system’s total CFI above 1.5 levels, demonstrating the system’s preparedness to deal with the current year’s operational challenges. However, multiple future years with similar operational results can erode those two ratios further, pushing the CFI below 1.5. Strategic long-term planning continues to be a critical process at all institutions to avoid such a result.

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, 2014 and 2013 included much of the CFI information that follows within the Management Discussion and Analysis section of the report.

Summary Ratios for FY2014 and FY2013

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. The FY2014 system CFI of 1.65 declined compared to the system’s 2013 CFI of 2.26.

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. The table illustrates the weight assigned to each measure, benchmark score, the overall system score, and the score calculated separately for the colleges (2 year) and the universities (4 year).

	<u>Weight</u>	<u>Benchmark</u>	<u>System</u>	<u>2 Yr</u>	<u>4 Yr</u>
Primary Reserve	35%	1.05	0.86	0.84	0.76
Viability	35%	1.05	0.89	1.19	0.56
Net Operating Revenue	10%	0.30	(0.18)	(0.08)	(0.29)
Return on Net Position	<u>20%</u>	<u>0.60</u>	<u>0.08</u>	<u>0.33</u>	<u>(0.20)</u>
Composite Financial Index (CFI)	100%	3.00	1.65	2.28	0.83

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 system FY2014 component performance reflects the operating stress felt by the colleges and universities. The material changes from FY2013 are in the Net Operating Revenue and Return on Net Position components declining from (0.01) and 0.46 respectively. The colleges performed better than the universities, reporting a small overall CFI decline of .10 from 2.38 to 2.28. The universities experienced a sharp decline from 1.93 to .83 with stable performance in the long-term measures and losses in the current operating measures.

Ratio Variability across Colleges and Universities

There is considerable variability in individual FY2014 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>	1.50	0.18	0.78
Viability – <i>debt coverage</i>	2.28	0.32	1.05
Net Operating Revenue – <i>surplus or deficit</i>	0.87	(0.40)	(0.16)
Return on Net Position – <i>asset stewardship</i>	<u>2.00</u>	<u>(0.80)</u>	<u>0.09</u>
Composite Financial Index (CFI)	4.49	(0.35)	2.07

Midpoint of Quartiles	<u>1st</u>	<u>2nd</u>	<u>3rd</u>	<u>4th</u>
Primary Reserve – <i>resource availability</i>	1.26	0.89	0.66	0.34
Viability – <i>debt coverage</i>	2.04	1.42	0.88	0.50
Net Operating Revenue – <i>surplus or deficit</i>	0.44	(0.09)	(0.23)	(0.35)
Return on Net Position – <i>asset stewardship</i>	<u>1.24</u>	<u>0.20</u>	<u>(0.05)</u>	<u>(0.49)</u>
Composite Financial Index (CFI)	3.94	2.70	1.60	0.33

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 budget 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 FY2014 represents a reserve balance of \$108.7 million, a decrease of \$.9 million, from FY2013. The board policy has established a target range of 5-7 percent for the colleges and universities. All 31 colleges and universities reported budgetary reserves within the policy range.

In FY2014, 23 of the system’s 31 colleges and universities generated negative net operating revenues using a generally accepted accounting principles measurement; this compares to 20

colleges and universities in FY2013. Of the 23 colleges and universities with negative net operating revenue in FY2014, 7 also had negative net operating revenue in FY2013 and FY2012.

	<u>FY2014</u>		<u>FY2013</u>		<u>FY2012</u>	
	<u>#</u>	<u>%</u>	<u>#</u>	<u>%</u>	<u>#</u>	<u>%</u>
Net operating revenue loss*	23	74%	20	65%	10	32%
Negative unrestricted net position	0	0%	0	0%	0	0%
Board reserves below 3%	0	0%	0	0%	0	0%

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

It is recognized that the Net Operating Revenues measure includes the impact of the non-cash accruals incorporated in the financial statements. Colleges and universities have been strengthening their cash budgeting practices in order to provide for the impact of these accounting adjustments on their financial statements. Net operating revenues totaled \$69,782,000 before the inclusion of the depreciation expense, which was \$113,497,000 in FY2014. After several years of improvement in the alignment of the cash and accrual dimensions of college and university budget practices, 2014 represents a setback.

2015 OUTLOOK

The leadership at the colleges and universities is working aggressively to manage the revenue and expense outlook during challenging times. The schools are operating with very thin margins as cost pressures build in compensation and operating inflation. The 2015 enrollment outlook requires focused planning, targeting enrollment growth strategies and expanded retention and student success efforts. The colleges and universities are reporting stable, but thin reserves as protection against enterprise risk.

Strategic enrollment management, strong program development and continued cost controls are key to successful year. Midyear enrollment and financial reviews are scheduled to begin in January, 2015. College and university balance sheet and income statement modeling is underway with the assistance of tools developed by the Finance division.

CONCLUSION

Minnesota State Colleges and Universities maintained a sound financial position in 2014. The system continues to rely substantially 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 FY2011. As on the occasion of past increases in the general unemployment rate, the system experienced corresponding increases in enrollment. The rebound in the state’s employment rate has led to corresponding decreases in system enrollment levels. Overall enrollment levels at the colleges and universities have decreased 3.6 percent, 2.3 percent, and increased 1.6 percent year over year in 2014, 2013 and 2012. Enrollment forecasts in 2015 and 2016 are slightly declining compared to 2014.

The system has in place a number of strategic initiatives for managing enrollment, including programs to increase the retention and success of existing students and programs to address the needs of diverse populations traditionally underserved by higher education. As student tuition becomes a bigger piece of Minnesota State Colleges and Universities' overall revenue totals, fluctuation in enrollment plays a bigger and more immediate impact; it will be critical to manage expenses at a rate that is less than the growth of revenue from state appropriations and tuition.

The system will also continue its management of costs to ensure efficient, effective operations on behalf of current and future students. Examples include developing a shared services platform for common business operations and strategic sourcing for the purchase of goods and services. In a comparison of similar institutions, MnSCU ranks 38 out of 51 states and the District of Columbia in overall administrative spending per student. The system is committed to realizing further efficiencies over the next biennium.

FY2014 and FY2013 Audited Financial Statements

Financial Statements of the system and select universities



Finance and Facilities Committee
Board of Trustees
January 28, 2015

Minnesota State Colleges and Universities

The Minnesota State Colleges and Universities system is an Equal Opportunity employer and educator.

Agenda

- FY2014 audited financial statements
- FY2014 financial performance
- Composite Financial Index (CFI)
- Financial monitoring protocols
- FY2015 outlook



Fiscal Year 2014 Audited Financial Statements Results

- System statements
- 4 university statements
- Revenue fund
- “Clean” opinions
- No material weaknesses
- No significant deficiencies



FY2014 System Financial Results are Stable

- Declining revenues with tight expense controls result in slightly negative college and university budgets
- System and college and university reserves stable but thinly funded
- College and university budget stress emerging in CFI calculations and operating losses
- System level and college/university level strategies to strengthen outlook



Changes in Net Operating Revenue

FY 2014 vs FY 2013

(includes colleges, universities and system office)

Revenue/(Expense) (In Thousands)	FY2014	Change	FY2013
Components and changes			
Revenue from students, net of financial aid	\$ 810,092	\$(27,061)	\$ 837,153
State appropriation revenue	591,242	37,996	553,246
Federal and state grant revenue	447,569	(11,958)	459,527
Compensation expense	(1,296,889)	(45,254)	(1,251,635)
All other revenues/(expenses), net	(595,729)	4,546	(600,275)
Net operating loss	\$ (43,715)	\$(41,731)	\$ (1,984)



Statement of Net Position

(includes colleges, universities and system office)

Assets, Liabilities and Net Position (\$ in Thousands)			
Fiscal Year	FY2014	FY2013	FY2012
Total Assets	\$3,142,907	\$3,125,332	\$2,955,024
Total Liabilities	1,044,196	1,042,654	963,414
Total Net Position	\$2,098,711	\$2,082,678	\$1,991,610

- Total assets increased each year due mainly to additional capital asset investments
- Total liabilities remained relatively unchanged



Statement of Revenues, Expenses and Changes in Net Position

(includes colleges, universities and system office)

Revenues, Expenses and Net Position (\$ in Thousands)			
Fiscal Year	FY2014	FY2013	FY2012
Total Revenues	\$1,952,094	\$1,982,854	\$1,937,771
Total Expenses	1,936,061	1,891,786	1,816,268
Change in Net Position	\$16,033	\$91,068	\$121,503

- Total revenue decreased by \$30.8 million due to the following decreases: \$33.8M in capital appropriation, \$27.2M operating revenue, \$9.4M in grants; with following offsetting increases: \$38M in state appropriation, and \$1.6M in interest and misc. income.
- Operating expenses increased by \$45.3 million due to an increase in compensation of \$45.3M and \$5.6M in depreciation, with offsetting decreases of \$5.6M in all other expenses.



System Composite Financial Index

(includes colleges, universities and system office results, excludes all foundation results)

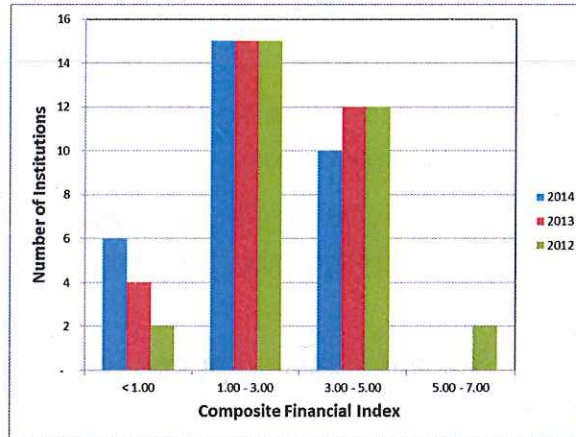
Components of CFI

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Return on Net Position	0.08	0.46	0.65
Net Operating Revenue	(0.18)	(0.01)	0.26
Primary Reserve	0.86	0.91	0.92
Viability	<u>0.89</u>	<u>0.90</u>	<u>0.95</u>
CFI	1.65	2.26	2.78



Composite Financial Index

Trends for College and Universities



Composite Financial Index

Variability in Colleges and Universities

	2014 Averages		2013 Averages		2012 Averages	
	Colleges	Universities	Colleges	Universities	Colleges	Universities
Primary Reserve	0.84	0.76	0.81	0.90	0.82	0.92
Viability	1.19	0.56	1.16	0.60	1.17	0.67
Net Operating Revenue	(0.08)	(0.29)	(0.07)	0.02	0.13	0.38
Return on Net Position	<u>0.33</u>	<u>(0.20)</u>	<u>0.48</u>	<u>0.41</u>	<u>0.60</u>	<u>0.68</u>
CFI	2.28	0.83	2.38	1.93	2.72	2.65



FY2014 Financial Summary

- CFI variability narrows amongst colleges & universities
- CFI trends have been declining the last two years, following enrollment declines
- System CFI relatively flat in the two long term measurements, with declines in the two short term measurements
- Campuses displaying focused budgeting, planning and analysis



FY2014 Monitoring Results

- 15 colleges and 5 universities reported negative accrual based operating revenue two years running
- 7 colleges and 4 universities reported CFI below 1.50 based on 2 year average or less than .5 in most recent year
- In total, eight colleges and three universities are under special review with management plan reporting to the Finance division



FY2015 Outlook

- Colleges and universities managing revenue and expense outlook
- Very thin margins require focused planning
- Stable, but thin reserves provide some protection for enterprise risk
- Strategic enrollment management and strong program development are key to successful year



Management Plan

- Financial management plan elements:
 - Peer review and assistance, enrollment strategies and tactics, revenue and expense forecast and monitoring
 - Margins improvement strategies
 - Instructional costs, administrative costs, reserve, facilities stewardship, cost study examination
 - Monthly, quarterly, biannual reporting to Vice Chancellor - CFO office

