

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

**Agenda Item Summary Sheet**

**Committee:** Finance and Facilities

**Date of Meeting:** January 18, 2011

**Agenda Item:** FY2010 and FY2009 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 2010 and 2009 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 2010 operating results yielded significant improvement in financial position at June 30, 2010, with a \$57.1 million net operating revenue surplus, rebounding from a prior year net operating revenue loss of \$9.3 million.

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

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

<b>BOARD INFORMATION</b>
<b>FY2010 and FY2009 Audited Financial Statements</b>

**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, 2010 and 2009. These financial statements were prepared by the Finance division of the Office of the Chancellor with the assistance of the campus Finance departments and have been audited by the firm of LarsonAllen LLP. This is the first year of a three year contract with LarsonAllen, Ltd. as the system auditor. These statements were presented to the Audit Committee by the Finance division and LarsonAllen LLP, at the November 17, 2010 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. 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 17, 2010, Audit Committee meeting. In addition, the three audit firms communicated results of internal control assessments in writing to the Board of Trustees.

Substantial progress was also reported on the two prior year significant internal control deficiencies: both deficiencies have been addressed and resolved. These prior year issues were related to system-wide technology data security and the timely reconciliation of local bank accounts for several colleges. A “significant deficiency” is an internal control deficiency or combination of deficiencies that based on auditor judgment may have more than a remote likelihood of failing to prevent or detect a misstatement that is more than inconsequential to the financial statements. It is a commendable achievement that no significant deficiencies were identified throughout the fiscal year 2010 audit process.

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 November 18, 2010 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 2010 and 2009 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, 2009.*" 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 2010 operating results yielded significant improvement in financial position at June 30, 2010, with a \$57.1 million net operating revenue surplus, rebounding from a prior year net operating revenue loss of \$9.3 million.

- Net assets increased \$179.6 million or 11.6 percent; most of the increase was due to fiscal year 2010 capital appropriation revenue of \$119.8 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 negative \$9.3 million in fiscal year 2009 to a surplus of \$57.1 million in fiscal year 2010. This net operating revenue surplus is the net of

\$1,859.6 million of operating and non-operating revenues less \$1,802.5 million of operating and non-operating expenses.

- Capital appropriation revenue of \$119.8 million plus other capital asset related revenue combined with the \$57.1 million net operating revenue surplus and generated a change in net assets of \$179.6 million, a significant increase from the \$106.8 million change in net assets generated in fiscal year 2009.

### **Consolidated Statements of Net Assets**

The primary driver of change within the Statements of Net Assets between June 30, 2010 and 2009 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 \$192.3 million was the primary factor increasing the capital assets balance, net of depreciation, by \$126.6 million.
- Capital asset financing came primarily from \$119.8 million of capital appropriation and \$27.5 million of new long-term debt.
- Net assets (e.g., net worth) increased \$179.6 million including a \$90.6 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 2010 operating expenses of \$1,802.5 million averaged \$4.9 million per day when divided by 365 days. Looking at the operating expense number in relation to liquid assets, the system's \$686.5 million of unrestricted cash and equivalents plus unrestricted investments would be adequate to cover approximately 4.6 months of expenses, an improvement of 0.4 months from fiscal year 2009.

- Revenue sources funding operations included \$614.2 million of state appropriation; \$756.3 million of student payments, net of scholarship allowance; \$447.7 million of federal and state grants; and \$41.4 million of other revenue.
- Expenses supporting operations included \$1,237.7 million of compensation, \$207.3 million of purchased services (utilities, enterprise and other IT support, etc.), \$92.2 million of supplies, \$88.4 million of depreciation and other expenses of \$176.9 million.

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

#### ***What is CFI?***

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. The CFI methodology is contained within the *Strategic Financial Analysis for Higher Education* (Sixth Addition), jointly developed and sponsored by the firms of

Prager, Sealy & Co., LLC, KPMG LLP and BearingPoint, Inc. 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.

The *primary reserve ratio* and *viability ratio* are measures of financial condition based on expendable net assets found on the Statement of Net Assets with each weighted 35 percent in the composite calculation. The *net operating revenues ratio* and *return on net assets ratio* are measures of financial performance based on results contained within the statements of revenues, expenses, and changes in net assets and are weighted 10 percent and 20 percent, respectively.

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.

### *Is CFI new to the System?*

The System started using CFI as an internal measure of financial health about six years ago. The CFI is also now a part of the Accountability Dashboard overseen by the Board of Trustees. The CFI is now included in the system procedure, “Financial Health and Compliance Indicators”, as a key metric for monitoring financial performance of each college and university. Colleges and universities incorporate CFI and other measures as deemed pertinent, including non-financial information, to prepare an annual “Financial Trends and Highlights” presentation. Audited colleges and universities present this annual assessment to the Vice Chancellor, CFO, as part of the external audit exit meeting. Colleges not subject to external audit present the same assessment at one of several meetings with the Vice Chancellor, CFO, where college leadership for 3 – 5 colleges plus system office finance personnel meet using a round-table discussion format. These have proven to be good learning and sharing opportunities.

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, 2010 and 2009 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 FY 2009 values in the Composite Financial Index (CFI) Comparisons table below are computed from ratio values contained in *Moody's Fiscal Year 2009 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 2010 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. Ratings may also be for a segment of a system or institution such as the System’s Revenue Fund, which is falls within the “Aaa” rating below.

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.

The System’s and Revenue Fund’s weighted components’ and composite values are compared below with those of the various rating categories extracted from the Moody’s median report. 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	FY10 System & Revenue Fund		Moody’s 2009 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	<b>0.70</b>	2.42	1.00	2.03	1.34	1.11	1.21	0.97	<b>0.74</b>	0.37
Viability	<b>0.84</b>	0.36	0.66	1.59	1.13	<b>0.88</b>	<b>0.79</b>	0.42	0.33	0.22
Net Operating Revenue	<b>0.48</b>	1.80	0.23	0.59	<b>0.47</b>	0.23	0.16	0.13	0.23	(0.10)
Return on Net Assets	<b>1.19</b>	0.80	0.29	(0.20)	(0.20)	0.20	0.33	0.36	<b>0.49</b>	(0.30)
CFI	<b>3.21</b>	5.38	2.18	<b>4.01</b>	<b>2.75</b>	2.42	2.49	1.88	1.78	0.46
	The shaded cells link System values to the closest value(s) within a credit rating category									
	<ul style="list-style-type: none"> <li>• The System ratios include the General Funds, Revenue Funds, Special Revenue Funds, Enterprise Funds, Agency Funds, and 9 Foundations deemed to be material.</li> <li>• 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 3.09 to 3.21 due primarily to the foundations’ collective realized and unrealized gains on investment. See <i>Combining Minnesota State Colleges’ and Universities’ Foundations Statements of Activities</i>.</li> <li>• Moody’s data includes 220 separate organizations.</li> </ul>									

**Summary ratios for FY2010 and FY2009**

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 2009 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>).

Moody’s national data population includes a wide range of rated public institutions, including Research I institutions, but does not include two-year colleges (except for those included in a system) and so is not strictly comparable in all respects to the Minnesota State Colleges & Universities system.

The fiscal year 2010 CFI of 3.21 improved from fiscal year 2009’s CFI of 1.62. These ratios represent Moody’s ratings of Aaa to Aa1 for 2010, much improved from A3 for 2009.

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>
Primary Reserve – <i>resource availability</i>	35%	1.05	0.70
Viability – <i>debt coverage</i>	35%	1.05	0.84
Net Operating Revenue – <i>surplus or deficit</i>	10%	0.30	0.48
Return on Net Assets – <i>asset stewardship</i>	<u>20%</u>	<u>0.60</u>	<u>1.19</u>
Composite Financial Index (CFI)	100%	3.0	3.21

**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>	1.24	0.12	0.54
Viability – <i>debt coverage</i>	3.50	0.23	0.81
Net Operating Revenue – <i>surplus or deficit</i>	1.00	(0.10)	0.46
Return on Net Assets – <i>asset stewardship</i>	<u>2.00</u>	<u>0.26</u>	<u>1.28</u>
Composite Financial Index (CFI)	6.66	0.97	3.21

Midpoint of Quartiles	<u>1st</u>	<u>2nd</u>	<u>3rd</u>	<u>4th</u>
Primary Reserve – <i>resource availability</i>	0.24	0.44	0.65	1.00
Viability – <i>debt coverage</i>	0.43	0.74	1.08	2.48
Net Operating Revenue – <i>surplus or deficit</i>	(0.01)	0.28	0.55	0.83
Return on Net Assets – <i>asset stewardship</i>	0.57	1.08	1.45	1.84
Composite Financial Index (CFI)	1.63	2.83	3.73	5.53

**Other Financial Measures**

There are additional financial metrics which are used to measure, monitor, and improve the financial condition of each college and university. A new system procedure, “Financial Health and Compliance Indicators” defines the purpose and process for performing important, on-going analysis of financial condition. The procedure also includes required action if certain performance levels are not achieved.

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 2010 represents a reserve balance of \$81.7 million, an increase of 1 percentage point, or \$9.9 million, from fiscal year 2009.

In fiscal year 2010, 6 of the system’s 32 colleges and universities generated negative net operating revenues using a generally accepted accounting principles measurement; this compares to 15 colleges and universities in fiscal year 2009. However it should also be noted that the consolidated net operating revenue improved dramatically from a negative \$9.3 million in fiscal year 2009 to a positive \$57.1 million in fiscal year 2010. Of the 6 colleges and universities with negative net operating revenue in fiscal year 2010, all 6 also had negative net operating revenue in fiscal years 2009 and 2008. Ongoing operating deficits negatively impact the ability of these 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>FY2010</u>		<u>FY2009</u>		<u>FY2008</u>	
	<u>#</u>	<u>%</u>	<u>#</u>	<u>%</u>	<u>#</u>	<u>%</u>
<b>Net operating revenue loss*</b>	6	19%	15	47%	19	59%
<b>Negative unrestricted net assets</b>	0	0%	1	3%	1	3%
<b>Board reserves below 3%</b>	1	3%	2	6%	2	6%

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

**TRENDS IN FINANCIAL AID**

In fiscal year 2010, there was significant growth in financial aid awards to Minnesota State Colleges and Universities students. Total dollars of financial aid reached \$1.2 billion, an increase of \$238 million or 25 percent, compared to fiscal year 2009. Additional key metrics related to changes from 2009 to 2010 in financial aid are:

- The number of financial aid recipients grew by 22,000, or 15 percent, to more than 166,000 students, during this same period.
- Fully 60 percent of all credit students now receive financial aid, up from 56% in 2009. Of this group more than half received more than one type of financial aid (grant, scholarship, loan, or work study).



- Grants were received by 40 percent of students in 2010.
- Grant awards increased by \$114 million, or 41 percent, most of which was increases in federal Pell grants.
- Student borrowing increased by \$117 million, or 19 percent, most of which was increases in federal loans.
- The number of students that borrowed increased by almost 15,000, or 15 percent, with 40 percent of students borrowing in 2010.
- The average award for all types and sources of aid increased by 8 percent, from \$6,752 in 2009 to \$7,274 in 2010.

Compared to 2003, total financial aid awards increased 127 percent, from \$533 million to \$1.2 billion, in 2010. Other noteworthy changes over the past eight years include;

- This growth came from both loans and grants, with approximately 2/3 coming in the form of loans and 1/3 coming in the form of grants.
- The number of financial aid recipients increased by 38 percent while total system headcount enrollment grew by 19% since 2003.
- The total amount of borrowing increased by 149 percent from \$301 million to \$749 million since 2003.
- The average loan from all sources increased by 53 percent from \$4,441 to \$6,788 since 2003.
- The average award for all types and sources of aid increased by 64 percent, from \$4,433 in 2003 to \$7,274 in 2010.

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.

In 2003, the financial aid allowance was \$172 million, or about 23% of total revenue. In 2010, the financial aid allowance was \$356 million, more than double the 2003 level, and about 29% of total revenue, a full 6 percentage point increase.

## **CONCLUSION**

The Minnesota State Colleges and Universities System maintained a relatively strong financial position in fiscal year 2010, as measured by the \$57.1 million net operating revenue surplus and the \$179.6 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 is enjoying unprecedented enrollment as more citizens are pursuing their education and job enhancing skills during these difficult economic times. The system continues to remain dependent on the state's support in order to maintain affordability and access for these students. The state's continued support is more critical now than ever as we educate Minnesota's workforce and fundamental participants of our state's economy.

*Date Presented to the Board of Trustees: January 19, 2011*