

**MINNESOTA STATE COLLEGES AND UNIVERSITIES  
BOARD OF TRUSTEES  
Agenda Item Summary Sheet**

**Name:** Finance and Facilities Committee

**Date:** March 17, 2015

**Title:** System Financial Resiliency Framework

**Purpose (check one):**

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

**Brief Description:**

This item is a follow up to the January committee discussions concerning the financial condition of colleges and universities. The presentation will review the Financial Resiliency Framework and outline the oversight of colleges and universities.

**Scheduled Presenter(s):**

Laura M. King Vice Chancellor – CFO

Earl Potter, President St Cloud State University

Tammy McGee, Vice President – CFO

Devinder Malhotra, President Metropolitan State University

Murtuza Siddiqui, Vice President - CFO

Dorothy Duran, President, Minnesota State College – Southeast Technical

Mike Kroening – Vice President - CFO

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

<b>INFORMATION ITEM</b>
<b>System Financial Resiliency Framework</b>

**BACKGROUND**

Minnesota State Colleges and Universities experienced rapid enrollment growth between fiscal years 2006 and 2011. The record-setting enrollment growth was driven in large part by the economic recession and high levels of unemployment that drove many young people as well as adult learners to our colleges and universities to upgrade their skills or learn a new profession. Between 2006 and 2011, the system's enrollment expanded 18 percent to 157,903 full-year equivalent (FYE) students. Since 2011, enrollment has declined and is projected to be 138,657 FYE in fiscal year 2015, slightly lower than 2008 enrollment levels but still 3.3 percent above 2006 levels.

Minnesota's strong economy and improved employment outlook, along with declines in the number of high school graduates and those 18-34 years old, have contributed to the declining enrollment levels which mirror national trends.

**MANAGEMENT STRATEGIC ACTIONS**

Colleges and universities have a number of short-and-long term tools and strategies available to plan for and adjust for these enrollment fluctuations. Further, the work of campus and system strategic planning is focused directly at the longer term remedies for this risk. Short- term strategies include focus on cost containment including operating cost reductions and staff and faculty adjustments. Colleges and universities have moved quickly to respond to revenue shortfalls with both temporary and permanent cost reductions. Longer term strategies are directed at improvements to enrollment levels, student retention and new revenue generation methods including customized training and continuing education program growth and efforts to increase grant attainment.

Our colleges and universities are not pursuing some strategies seen in a general business environment. We are not considering the closing of campuses or major labor cost structure changes.

**ADVENT OF THE COMPOSITE FINANCIAL INDEX**

Each of our colleges and universities is separately accredited by the Higher Learning Commission (HLC). In 2007, the HLC instituted a reporting requirement known as the Composite Financial Index (CFI). The commission established ranges for the index and triggers of financial performance that required heightened oversight and reporting. The CFI has many benefits for uniform,

comparable financial reporting and trend monitoring across various sized institutions with diverse revenue and expense profiles. Its advent has also moved reporting into an accrual methodology which is newer to the public sector environment.

There are significant differences between cash based and accrual based reporting of results. At the system level, the bottom line changes close to \$100 million when cash statements are adjusted for accrual entries related to depreciation and accrued employee benefits. Consequently, colleges and universities may have adequate cash balances and negative accrual results. The challenge for the finance division and the college and university financial leadership is to recognize and respond to both cash and accrual results in the monitoring and reporting framework.

## **FINANCIAL RESILIENCY RESULTS**

At its June 2014 meeting, the Board of Trustees asked the Vice Chancellor of Finance and Facilities to evaluate each college and university's financial condition and ability to withstand enrollment declines. System office staff consulted with a group of campus chief financial officers (CFOs), researched measures, evaluated methodology, and analyzed data to create the "College and University Financial Resiliency" measurement instrument.

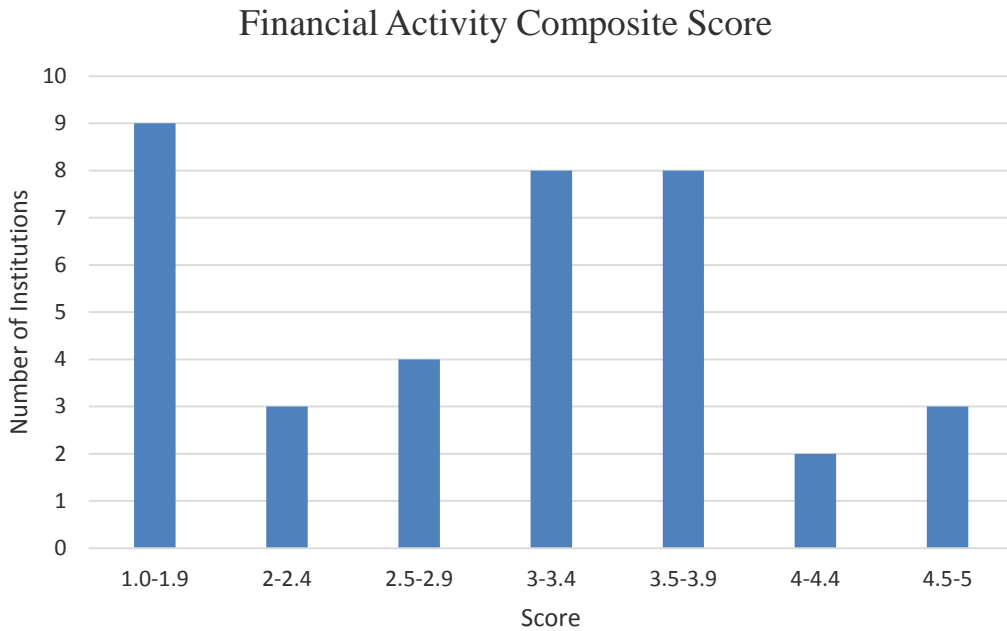
The financial resiliency framework was designed to measure the financial condition of colleges and universities and their capacity to withstand enrollment decline or other revenue or expense shocks. The financial measures address both balance sheet condition and income statement performance. The objective of the financial measures is to reflect both longer term financial capacity and shorter term results. The monitoring and reporting tools that have been developed recognize this tension and have accommodated it in their design.

The four financial measures include CFI, net income/loss, cash position, and change in unrestricted net assets. Colleges and universities were scored on a scale of one to five for each measure, with one being least resilient and five most resilient. The four financial measures were averaged to create the financial activity composite score. This composite score, with both balance sheet and income statement measures, evens out the impacts of short term events, and will become more meaningful as years of results are compared.

## **RESULTS**

- The financial activity composite score is the average of the four financial measures: CFI, net income/loss, cash position, and change in unrestricted net assets.
- The average financial activity composite score was 2.9 systemwide; the median score was 3.0.

- The colleges averaged 3.0 and the universities averaged 2.4. This reflects the college's stronger CFI and net income/loss performance compared to the universities.



*Financial Activity Composite Summary Graph 1*

## **FINANCIAL HEALTH INDICATORS**

The financial resiliency framework complements the financial health indicators specified in board policy 7.3.16. According to board policy, a college or university that does not meet certain financial performance thresholds is required to prepare a financial workout plan. As a result of the fiscal year 2014 financial results, eleven colleges and universities did not meet the threshold for CFI performance. Those institutions either had a CFI less than 1.5 based on a two-year moving average or a CFI score under 0.5 for fiscal year 2014. In fiscal year 2013, nine colleges and universities were required to submit financial recovery plans as a result of their low CFI scores.

Of the eleven colleges and universities that did not meet the threshold for CFI performance, seven had a financial activity composite score of less than 1.9 and the remaining four institutions had a score less than 2.9 for fiscal year 2014.

## **FINANCIAL RECOVERY PLAN REQUIREMENT**

The eleven institutions that did not meet the CFI threshold have submitted a written recovery plan to the system office. The plans include:

- detailed, measureable steps tied to a fiscal year
- the projected impact of the steps
- analysis of mid-year interim financial statements
- comparison of actual results against expected results
- narrative linking the plan to Higher Learning Commission criteria for accreditation

System office finance staff have reviewed the financial recovery plans and have met with leadership from several of the college and universities to discuss their plans, their underlying assumptions, and their implementation strategies. Several plans required revisions and additional follow-up. The chancellor has been briefed on the condition of these schools and is engaged with the presidents. System office finance staff will continue to monitor financial performance and adherence to plan.

## **ASSESSMENT OF COLLEGES AND UNIVERSITIES ON FINANCIAL RECOVERY PLANS**

Enrollment loss was the largest contributing factor to poor financial performance in fiscal year 2014. Other factors contributing to poor performance were the lag between budget shortfalls and the ability to implement budget decisions, and unanticipated environmental issues associated with a capital project. Transition in key campus leadership positions, especially the president, chief financial or academic officer, also played a role in the financial performance of some institutions.

The following section describes the issues contributing to the financial performance of colleges and universities required to submit financial recovery plans.

### **St. Cloud State University**

A CFI score of 0.07 in fiscal year 2014 triggered the financial recovery plan requirement for St. Cloud State University. The university reported a \$12.3 million operating loss in fiscal year 2014, accounting for 28 percent of the system's total operating losses. The budget shortfall was triggered by steep enrollment declines and a slow budgetary response to changing conditions. Enrollment has declined 17.3 percent since fiscal year 2011 and is expected to fall 5.1 percent in fiscal year 2015.

Lack of stability in financial and academic leadership positions over the past three years was also a contributing factor to its financial performance. St. Cloud State University accounts for 10.6 percent

of the system's budget; the significant financial challenges it faces has increased the risk to the overall system's financial health.

The university has submitted a 2015 plan which projects a fiscal year 2015 general fund operating deficit (on a cash basis) of \$8.5 million after \$4 million in budget reductions. The plan also calls for \$10 to \$12 million in additional reductions in fiscal year 2016; however, to achieve these savings the reductions would need to be implemented early in the fiscal year. Finance staff will continue to work with the university to achieve stronger 2015 and 2016 results.

The university has also launched program and service portfolio reviews, cost reduction, resource management strategies and enrollment development efforts. The program review effort is scheduled to be completed by May 2015 and is a crucial part of the risk management strategy for the university. Achievement of at least \$4 million in outlined reductions in fiscal year 2015 and the planning necessary to strategically reduce at least \$10-\$12 million in fiscal year 2016 are critical to reaching a stable financial outlook.

### **Metropolitan State University**

A CFI score of (0.08) for fiscal year 2014 triggered the financial recovery plan requirement. The university reported an operating loss of \$6.0 million dollars, accounting for 14 percent of the system's total operating losses last year. The operating loss was the result of an unanticipated environmental issue at a building construction site that required use of \$3.7 million in fund balance/reserves.

The university's CFI forecast for fiscal years 2015, 2016 and 2017 is made volatile by the very large capital construction spending moving through the calculations. The outlook includes acceptable CFI results in 2015 and 2016 and a dip below 1.0 in 2017 as the capital spending comes to completion. The preliminary recovery plan forecasts a \$6.5 million operating deficit (accrual basis) in fiscal year 2015, improving to a negative \$1.5 million in fiscal year 2016.

Metro State University's enrollment has been relatively stable compared to other universities. Its enrollment increased by 342 FYE between fiscal year 2011 and fiscal year 2014, one of the few institutions to show growth compared to the peak enrollment year of fiscal year 2011. Its enrollment is expected to decline one percent in fiscal year 2015. Continued attention to the academic and enrollment planning now underway should deliver on the planned results.

## **Minnesota State College – Southeast Technical**

A CFI score of (0.35) in fiscal year 2014 triggered the financial recovery plan requirement for Minnesota State College – Southeast Technical, the second consecutive year the college has been required to submit a plan. Steep enrollment declines and restructuring of their nursing program resulted in a \$1.8 million operating loss in fiscal year 2014, accounting for four percent of the system's operating losses last year. Enrollment has declined 19.6 percent since fiscal year 2011 and is expected to fall 10.4 percent in fiscal year 2015.

The fiscal years 2015, 2016 and 2017 CFI forecast returns finds the college returning to above 1.0 performance with an outlook for positive accrual based operating results by fiscal year 2019, a significant accomplishment. The college has committed to \$1 million in fiscal year 2015 operating budget reductions, with approximately 50 percent base level reductions. The college has made significant reductions and moved to a shared services arrangement with Winona State University for their human resources services. The success of their recovery plan is contingent upon enrollment growth in new/restructured programs. A concern for Minnesota State College – Southeast Technical is a low level of reserves/fund balance, leaving the college at risk for unexpected enrollment declines and other unexpected budget shortfalls.

### **Financial Recovery Plan Trends**

In addition to Minnesota State College–Southeast Technical, six other colleges were required to submit financial recovery plans due to low CFI scores: Hennepin Technical College, Hibbing Community College, Century College, Minneapolis Community and Technical College, Minnesota State Community and Technical College, and Mesabi Range College. These colleges had CFI scores ranging from 0.23 to 1.58, with all colleges reporting operating losses.

The largest contributing factor leading to poor financial performance at the colleges was enrollment loss. All six colleges recorded double digit enrollment declines between fiscal years 2011 and 2014, with enrollment losses ranging between from 11.2 percent to 17.2 percent.

In addition to St. Cloud State University and Metropolitan State University, Southwest Minnesota State University and Minnesota State University, Mankato were required to submit financial recovery plans due to low CFI scores. These universities had CFI scores of 0.19 and 1.21, respectively. Large debt/depreciation expenses contributed to the low CFI scores, with enrollment declines playing less of a factor.

## **CONCLUSION**

The financial resiliency framework has helped identify areas where the system is more resilient (cash position and net assets) and less resilient (net income/loss). It also highlights areas where more work could be done to support resiliency (enrollment projections). The resiliency scores correlate closely with other measures of financial health the system monitors, supporting the validity of those measures and the ability of the system to identify colleges and universities at financial risk.

Eleven colleges and universities have submitted financial recovery plans as a result of low CFI scores. These institutions also received low scores in the financial resiliency framework. The system office is currently working with colleges and universities who have submitted financial recovery plans and will monitor their financial performance against their plan.