

MINNESOTA STATE COLLEGES AND UNIVERSITIES

BOARD OF TRUSTEES

SYSTEM FINANCE (Finance 101)

STUDY SESSION MINUTES

NOVEMBER 14, 2012

Board of Trustees Members Present: Chair Clarence Hightower, Trustees Ann Anaya, Brett Anderson, Margaret Anderson Kelliher, Duane Benson, Alexander Cirillo, Cheryl Dickson, Philip Krinkie, David Paskach, Maria Peluso, Tom Renier, Louise Sundin, Michael Vekich

Present by Phone: Trustee Ann Anaya

Leadership Council Representatives Present: Chancellor Steven Rosenstone and Vice Chancellor Laura King, President Richard Hanson, President Joe Opatz

SYSTEM FINANCE (Finance 101)

The Minnesota State Colleges and Universities Board of Trustees held its meeting on November 14, 2012, 4th Floor, McCormick Room, 30 East 7th Street in St. Paul. Chair Hightower called the study session to order at 8:00 a.m. and noted that Trustee Ann Anaya was participating by phone. Chair Hightower introduced the presentation as a follow-up to the September board retreat where there was expressed interest in a high level overview of the finances of the system. No decisions will be made as a result of this session.

Chair Hightower asked Trustee Vekich to chair the discussion.

Trustee Vekich stated that this presentation is meant to introduce new members to the system financial structure and provide review for returning members.

Originally, this session was to follow the presentation in the Audit Committee of the system's 2012 financial statements. Because that has been delayed, the 2012 financial results in the presentation are noted as 'unaudited' per arrangement with the system's auditors.

The presentation is broken down into three sections. The first section summarizes board policy and the operational procedures that govern the board's delegation to the chancellor and his in turn to presidents. It includes an articulation of the board's control and assurance structure and the methods the vice chancellor uses to gain continuing assurance. The second section is an overview of the system's operating budget and the Allocation Framework and the final section concerns the system's Capital Investment Program.

Trustee Vekich turned the discussion to Vice Chancellor Laura King. Vice Chancellor King recognized Deb Bednarz, Denise Kirkeby and Brian Yolitz, who helped put the presentation together.

Board Policy/Operational Procedures

Vice Chancellor King explained that the board's primary role is to set fiscal policy and carry out responsibilities defined in state statute, law or board policy – it's focus is on the big picture while ensuring that proper policies, procedures and systems are in place to for fiscal integrity.

State Statute delegates to the board “all powers necessary to govern the state colleges and universities and all related property”; but occasionally certain authorities have been taken back, This includes capping tuition in law, the 60/120 credit requirement and preventing Anoka Technical College from closing.

Under Board Policy 1A.2, the Finance and Facilities Committee of the board is charged with oversight of all systemwide fiscal, facility and technology matters, matters related to system pension plans, and oversight of system foundation relations and development. This includes the allocation formula, biennial budget development, tuition, capital budget requests, and annual gifts and grants reports.

State statute has reserved some powers to the legislature including the appointment of Trustees, institutional missions, establishment of new permanent sites, final approval of all labor contracts, sale of general obligation bonds, Revenue Fund indebtedness limitation, administrator personnel plan design, and salary schedules.

Generally, board policy concerning finance and administration are contained in Chapters 5, 6 and 7 which went through a substantial re-structuring in 2000. Since then, in accordance with board policy, they are reviewed every 5 years.

The board approves substantial items of policy including long term financial policy issues (reserves, bond sales, retirement program administration); major revenue and expense items (annual budgets, tuition rates); long term asset alterations (acquisitions/dispositions); and multi-year planning documents (capital budget, technology master plan). Vice Chancellor King reported that on average per year, the board approves approximately four contracts, one or two land sales, one or two acquisitions, and bond sales generally every other year. Vice Chancellor King added that some time will be scheduled for the board to review the retirement program which is administered through contract with TIAA-CREF. The Human Resources committee of the board has oversight on the plan design and its relationship to other state pension programs while the Finance Committee has oversight of the financial and fiduciary issues.

Vice Chancellor King explained that under statute the board can and has delegated certain authorities to the chancellor. In turn, the chancellor can delegate certain authorities to the presidents who, in turn, can delegate some authority to his/her staff. The chancellor has a standing delegation in his absence. Trustee Benson asked why the naming of buildings was delegated to the chancellor. Vice Chancellor King answered that this was most likely a hold-over from old policies that were rolled over at time of merger.

Trustee Renier asked why the language concerning contracts state “over” rather than “up to.” Vice Chancellor King said this is another conflict in our structure of approvals. Conversations have taken place concerning the conflict and there is a possible need for modification. Trustee Dickson said that it seems that the statement should read that chancellor has delegated authority for contracts between \$100K and \$3M rather than over \$100K. Vice Chancellor King agreed and added that the board approves contracts over \$3M, the chancellor approves contracts over \$100,000 and up to \$3M, and presidents can approve contracts under \$100,000. In addition, there are board procedures in place to manage the delegation of authority process and to allow delegation of authority to interim presidents, and documents are on file authorizing the delegations. Oversight is always present and in the absence of the chancellor (unavailable or unable to act), there are procedures that define a clear chain of authority.

Trustee Hightower asked for examples of authority from the legislature that is given directly to the campuses. Vice Chancellor King said she will provide a full list of those instances.

Vice Chancellor King reported that the control environment of the system is very layered. The board, the chancellor and the presidents all have oversight and monitoring methods. Under board policy, the Audit Committee approves an audit workplan which lays out the audit strategy for the upcoming year; Board Policy 5.10 articulates the board’s expectation for cash reserves at the system office and campuses; the Composite Financial Index (CFI) and the Facilities Condition Index (FCI), along with a number of other reporting procedures (annual financial statements, Trends and Highlights meetings, accountability dashboard, etc.) ensure that the board is kept abreast of the assurance practices in place within the system, and the system’s current exposure to risk. Currently three schools will be required to have workout plans for FY2013 based on FY2012 performance.

Trustee Krinkie said in the past, there have been audit findings related to overpayment on payroll annual leaves and asked what has been done to prevent risk in this area. Vice Chancellor King responded that it was determined that there are a number of technology changes that need to take place and some have been completed. Vice Chancellor King said she will find out the status and report back.

Trustee Hightower asked if there is anything in the wrong place under the current cascade of delegations. Vice Chancellor King responded that calendar management has routine items (like contract approvals) come before the board. The system office staff have fully reviewed these items, and while board guidance is appreciated, they take up the board’s time. Chancellor Rosenstone added that it is the intention of the policy construction for the board to delegate and provide oversight rather than manage.

Trustee Benson asked if there are any policies not in line with state law. Vice Chancellor King said that the competitive bidding process comes to mind. Gail Olson from the Office of General Counsel stated that there are many areas that have flexibility, and this is one of them. The Legislature is approached by MnSCU regularly for changes and modifications. Vice Chancellor King said an example is the provision for MnSCU to continue its operations in the case of a state shutdown. Trustee Vekich asked if it would be valuable to establish a formal review of what currently exists and what should be taken to the legislature

for modification. General Counsel Olson replied that policies are reviewed every five years and the statutes are reviewed proactively by her and Vice Chancellor King. Trustee Hightower said it is difficult to expect staff to make recommendation to the board concerning modifications to the delegation process and suggested members of the board (Trustees Vekich and Renier) meet with staff leadership to be involved in the process. Vice Chancellor King answered that she would welcome that assistance.

Operating Budget and the Allocation Framework

Vice Chancellor King reported that MnSCU depends on three primary operating revenue sources – state appropriation, tuition and federal and state grants. Factors influencing revenues include the state economic outlook, public support for higher education, tuition rates, enrollment and financial aid.

On the expense side, the primary cost driver is compensation, accounting for 66% of MnSCU's all-funds expenditures. MnSCU negotiates contracts with three faculty units and the state negotiates contracts for the statewide bargaining units. The state also negotiates the state employee benefits package.

Other cost drivers are the cost of maintaining and developing enterprise-wide systems such as ISRS and the size of the campus physical plant – building operations, maintenance and preservation. Vice Chancellor King drew attention to the fact that the \$1 per square foot facilities spending guideline is the only place in policy where a spending expectation is articulated.

Vice Chancellor King noted that the total 2012 preliminary revenue is \$1.879B. Net tuition and financial aid accounted for almost half of the FY2012 revenue and 40% of tuition revenue is derived from state and federal financial aid programs. Total revenues have increased 27% over the past eight years. In 2004, financial aid accounted for 27% of gross tuition and by 2012, it accounted for 37% of gross tuition. The costs to students has been flat, but there is a substantial dependence on financial aid.

Trustee Benson commented that unlike K-12 which is funded on a per student basis, MnSCU is funded in lump sum fashion and inquired if it is desirable to have increasing or decreasing enrollment. Vice Chancellor King replied that enrollment doesn't really have an impact on our appropriation bottom line but from a mission perspective, there should be increasing enrollment. There are schools that have been successful in managing growing enrollment with decreasing state allocation. Chancellor Rosenstone added that it is critical that MnSCU provides access to higher education and high demand programs - some that are high cost that can't be covered by tuition alone. Without sufficient state support, MnSCU will be unable to grow these programs that our business communities are calling for.

Vice Chancellor King said the all funds expenses include salaries (50% of total expenditures), benefits (FICA, insurances, retirement, and tuition waivers), purchased services, supplies, utilities (\$32M per year) and other items such as depreciation and repair and replacement.

Trustee Renier asked what the tuition waiver program entails. Vice Chancellor King responded that it is a labor contract driven employee benefit that differs by contract. It is a staff development component that gives employees and their families an opportunity to access higher education within our system via tuition waivers.

Vice Chancellor King stated that from 2010 to 2012, revenue declined 2.9%, expenses declined 2.7% and the gross margin remained flat at 3.4% - 3.6%. A positive gross margin is the single most powerful means for a campus to improve its CFI, or protect it from downward forces on the balance sheet.

Total state support per FYE has fallen 45% since 2000 in inflation adjusted dollars. Disinvestment in Minnesota higher education has been deeper than in all but eight other states over this period. MnSCU responded by increasing faculty and staff productivity, cutting administrative costs, using space more efficiently and imposing a wage freeze and modest tuition increases. Thanks to the leadership of the presidents, the real cost of educating a MnSCU student is down 10% since 2000.

The operating budget has been stable over the short term, but there is pressure and long term risks in enrollment, tuition and financial aid revenue, gifts and fundraising, state support and wage and benefit costs. The chancellor anticipates attention on the system's long term financing strategy as part of the work on the Strategic Framework.

Trustee Anaya asked if there is a year by year illustration to demonstrate the 45% decrease in state funding and suggested it is time to approach the legislature with a request to restore state support to previous levels. Vice Chancellor King said that information can be accessed. Chancellor Rosenstone said that this information has been shared with the Governor, Minnesota Management and Budget, and the legislature and there is an understanding of this trend on all levels. MnSCU's strategy is to focus on the deliverables per the Strategic Framework and the new investments required that will allow the goals to be achieved.

Vice Chancellor King continued with an overview of the Allocation Framework. The Allocation Framework is the board approved methodology used to distribute state funds to the colleges/universities in three ways – a base allocation, systemwide set asides, and system office support. As a result of state decline, only 26% of total revenue ran through the model in 2013 as opposed to 40% in 2000. Efforts have been made in the past five years to move as much as possible to the base allocations and out of special initiatives. The system office authorization is 6% of the total, currently \$33M. Trustee Anderson asked if this has always been the case. Vice Chancellor King answered that prior to the legislature's line item appropriation to the system office (effective FY2010); there was agreement with the colleges/universities that the system office spending would travel as a consistent percentage of the total revenue. Since the system office has no tuition revenue, when state appropriation was reduced, the share of appropriation increased. However, the share of total revenue has remained flat.

The breakdown of the Allocation Framework design is as follows – 8% for systemwide set asides, 3% for priority funds to campuses (such as access and opportunity) and 83% for

campus base allocation which determines funding to campuses based on the school's enrollment, instructional costs and other factors. The presidents are given a great deal of discretion on how these funds are spent.

The Instructional Cost Study is an important component of the Allocation Framework, and it is used by colleges and universities to plan program offerings. It takes into account the different costs of programs. The model calculates the average cost of delivering a program across the system and calculates a band. Programs and courses that lay within the band are fully funded. Those who exceed or are below the band are funded at the level of the band. This is one way to get more money to costly programs, and it creates an incentive to manage program costs within the band. Chancellor Rosenstone added that this is a way to get funds to the more costly programs and it is an incentive for cost efficiencies within the curriculum. Trustee Cirillo asked if this incents schools to change programs to high cost programs because they would get more money. Vice Chancellor King replied that it allows for it, but it is not believed to incent that behavior. Chancellor Rosenstone noted that the college or university would incur expensive, fixed costs to establish a high cost program and such costs wouldn't be recovered, so it really does not incent.

Vice Chancellor King stated that the system has a Technical Advisory Committee which reviews the model regularly to ensure that it is still performing in the manner intended. Trustee Hightower inquired how the state money follows enrollment changes. Vice Chancellor King replied that the instructional component is based on enrollment, administrative and student support and has an FYE component but takes into account some national benchmarks, facilities is based on headcount, and libraries and research are not linked.

Capital Financing

Vice Chancellor King reported that MnSCU has a mature systemwide Capital Planning process, replacing the individual requests that existed pre-merger. The process includes pathways for General Obligation and Revenue Fund support and there is little investment from outside sources. The board will be asked to approve the 2014 Capital Budget next spring.

The system's capital assets are valued on the balance sheet at cost, net of depreciation. The values on the balance sheet do not represent replacement value so they are vastly understated. The average age of our building stock exceeds 40 years. Trustee Hightower asked what the overall condition of the buildings are, considering their age. Vice Chancellor King answered that as a system, there has been substantial investment in basic infrastructure over the past 10 years including investments in roofs, windows and energy systems. Overall, the FCI rating is in the 12% range, which is very respectable. However, since the system owns a lot of real estate, that will require a continued substantial investment. The system's legislative requests have had HEAPR funds as the number one priority since 1998. The system average is \$1.20 per square foot in annual repair and replacement spending from operating budget funds which equated to \$26M in 2012. Over the years the board has adopted a general capital investment plan which targets 3% of annual operating budgets as

the debt service goal and contemplates \$150M per biennium in new capital expenditures, exclusive of HEAPR. The model is re-run every two years to update enrollment, revenue and capital expenditure assumptions. The board will see a new run next spring as part of the 2014 Capital Budget plan. Vice Chancellor King noted that debt service accounts for a very small share of total spending each year, with individual colleges/universities paying a 1/6 share and the system paying a 1/6 share.

In closing, Vice Chancellor King stated that with the delegation process in place, the system is operating in a very stable, predictable environment and if there are items that trustees would like to know more about, additional study sessions can be arranged. Chancellor Rosenstone said that today's session provided trustees an opportunity to think about if current oversight is at an appropriate level, if the long term financial model is sustainable, if other options might exist, if there are areas in need of change and if the right management tools are in place to incent the right behaviors.

Trustee Benson said that emerging markets should be looked at and see if there is anything missing.

Trustee Vekich thanked Vice Chancellor King for the presentation and adjourned the meeting at 9:37 a.m.

Respectfully submitted,

Laury Anderson, Recorder