Financial Fundamentals for the New President

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Bethel University

- Established in 1871 by John Alexis Edgren with the conviction that Christians ought to love God with their minds and represent Him in all fields

- Approximately 3,700 students including Undergrad, Grad and Adult Studies

- Recent Events:
  - Tuition Repositioning
  - Career Commitment
  - Anderson Family School of Health Sciences
  - Success of Athletic Programs

BETHEL UNIVERSITY

TOPICS

- Financial Statements
- Asset Classifications
- Endowments
- Budgeting & Forecasting
- Capital Planning
- Key Ratios – Composite Score
- CFO as a Strategic Business Partner

Financial Statements

- **Statement of Activities (Income Statement)**
  - Provides visibility to how well an institution manages its resources over a stated period of time
  - *Revenues – Expenses = Surplus / (Deficit)*

- **Statement of Financial Position (Balance Sheet)**
  - Provides visibility into the cumulative effect of resource management over time
  - *Asset – Liabilities = Net Assets*

- **Important to review these regularly**

- **Important to understand how these statements interact**

Statement of Activities

Net Tuition Revenues
Auxiliary Revenue
Gift Revenues
Endowment
Funds Released From Restriction
Investment Income
TOTAL REVENUE
Salaries & Wages
Benefits Expense
Auxiliary Expenses
Utilities
Marketing
Office Supplies
Software & Technology
Maintenance & Repairs
Interest
Depreciation
TOTAL EXPENSE
NET SURPLUS / (DEFICIT)

- **Revenue**
  - Can be restricted or unrestricted
  - Tuition revenues net of any *Unfunded* tuition assistance
  - Auxiliary revenue, including housing and meal plans, is generated from services provided
  - As restriction on funds get released, revenue is generated
- **Expense**
  - Salaries, wages & benefits typically are the largest expense for an institution
  - Categorization of expenses, for accounting purposes, identifies the type of expense
    - IPEDS categorizes expenses by functional activity (instruction, research, student services, etc.) identifies the
- **Net Surplus / (Deficit)**
  - Generally, represents the contribution to Net Assets from ongoing operations

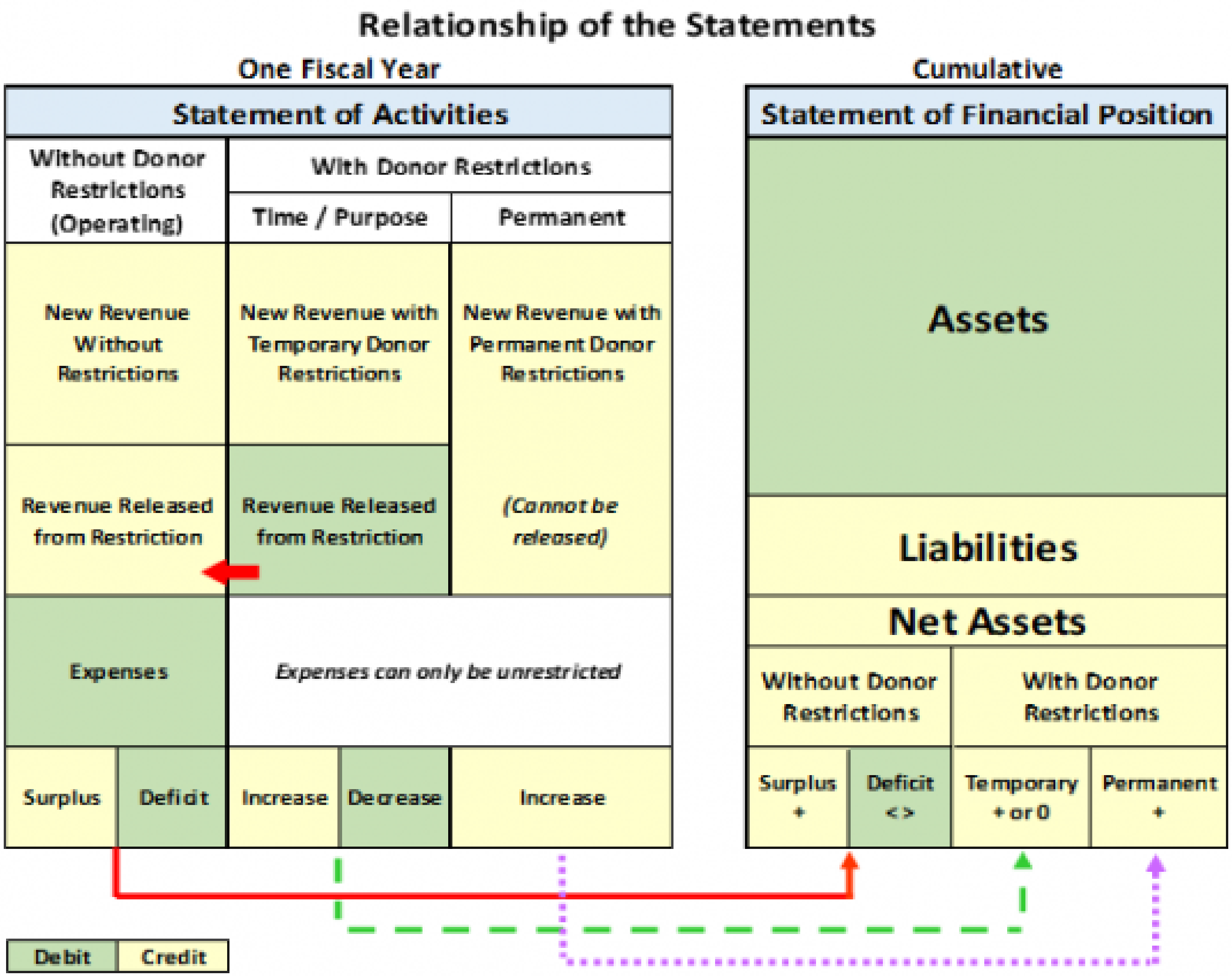
Statement of Financial Position

ASSETS:	
Cash and Equivalents	
Recievables	
Prepaid Expenses	
Other Current Assets	
Total Current Assets	
Property Plant & Equipment	
Long-term Investments	
(Accumulated Depreciation)	
Total Non-Current Assets	
TOTAL ASSETS	
LIABILITIES:	
Payables	
Prepaid Income	
Accrued Expenses	
Total Short-Term Liabilities	
Long-Term Debt	
TOTAL LIABILITIES	
TOTAL NET ASSETS	
TOTAL LIABILITIES + NET ASSETS	

Must Equal

- **Assets = Liabilities + Net Assets**
- **Assets**
  - What the organization owns
  - Categorized as current (<1 year) or non-current
  - Expressed net of accumulated depreciation
- **Liabilities**
  - What the organization owes
  - Categorized as short-term (<1 year) or long-term
- **Net Assets**
  - The difference between Assets and Liabilities
  - Broken down into two categories:
    - Unrestricted – Funds available for general use, usually categorized between “undesignated” and ”Board Designated”
    - Donor Restricted – Available for use as directed by a donor

Financial Statements



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Asset Classifications

- Assets are generally classified in one of two categories:

  1. *Restricted* – Funds or donations that have specific restriction on how they can be used.

     - Restrictions are defined by the donor
     - Often used to support a specific program, project and/or purpose
     - Generally do not have an expiration date
     - Examples:
       - Endowed scholarships and appointments
       - Real estate given for a specific purpose

Asset Classifications

- Assets are generally classified in one of three categories:

  2. *<u>Unrestricted</u>* – Funds or donations that can be used for any purpose over any time frame

     - Could be donor based, or generated from regular operations
     - Restriction on funds could be set for a specific purpose, program or time period
     - Examples:
       - Operating cash
       - Annual unrestricted fund raising

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Endowments

- *Purpose*: Endowments are established to provide long lasting benefit to a particular mission or purpose
- *Legality:* An endowment is a legally binding agreement between the donor and the institution
- *Perpetuity*: Endowments do not have end dates associated with them and are intended to last in perpetuity
- *Investment:* Endowed assets are typically invested in a mix, depending on risk profile, of various investment vehicles including stocks, bonds, Mutual Funds, ETF's and REITs
- *Withdrawal Policy:* Withdrawals from the endowment are based on a static calculation taking into account expected market returns of investments, and the cash needs of the organization

Endowments

- *Endowment Withdrawal Calculation Example:*
  - Assumptions:
    - Endowment Value - $50M
    - Expected Annual Returns – 7%
    - Annual Withdrawal Amount – 4% of Endowment Ending Balance
      - ➢ Withdrawal Calculation = Beg Bal * 4%

	Year 1	Year 2	Year 3
Endowment Balance - Beginning of Period	**$50,000,000**	**$51,360,000**	**$52,756,992**
Expected Market Gains @ 7% per Year	3,500,000	3,595,200	3,692,989
Annual Withdrawal Amount @ 4%	(2,140,000)	(2,198,208)	(2,257,999)
Endowment Balance - End of Period	**$51,360,000**	**$52,756,992**	**$54,191,982**

- **Two Observations:**
  1. The Endowment value continues to grow
  2. The amount of the annual withdrawal grows along with the Endowment

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Budgeting & Forecasting

- **<u>Budgeting</u>** is typically completed *before* the start of a new fiscal year
  - Is built based on a set of assumptions, including
    - Enrollment (new traditional starts, transfers, grad rates, etc.)
    - Staffing levels (including vacancy assumptions)
    - Inflation
    - Planned investment
    - Gift receipts
    - Investments

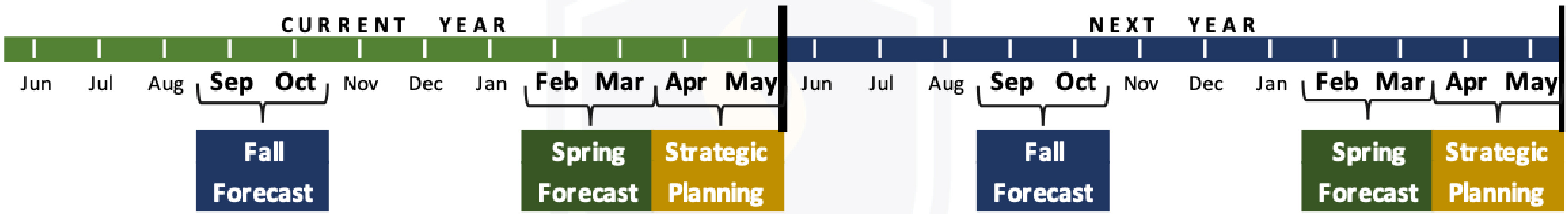
- There is a ***<u>very high</u>*** probability that there will be some variation in every one of these assumptions

- Regular review of Budgeted assumptions is essential to maintaining a balanced budget
  - Monthly reviews that highlight variance to Budgeted assumptions
  - Communication with the community to ensure alignment with financial status

Budgeting & Forecasting

- **Forecasting** is typically completed *during* the fiscal year
- Forecasts are built using currently available financial information, with updates to the assumptions used in the Budget
- Timing of the Forecast should correspond to fiscal events (i.e. start of a semester)
- Forecasts provide the institution an opportunity to react to changes to budgeted assumptions (lower enrollment)
- Coordination and communication with budget holders is critically important

Budgeting & Forecasting



	Fall Forecast	Spring Forecast	Strategic Planning
Process Inputs	•final fall enrollment numbers •expenses and headcount through first four months •items impacting financial performance not included in budget	•final spring enrollment numbers •expenses and headcount through first eight months •items impacting financial performance not included in budget	•Spring Forecast •strategic initiative reviews •long-range growth planning •Investment requirements
Process Outputs	•revised current year financial goals/targets •preliminary budget for next year	•revised current year financial goals/targets •detailed budget for next year	•final review and recommendation of next year budget •5-year plan

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Capital Planning

- **Capital Planning** *identifies* current institution needs and new investment opportunities, then *prioritizes* them based on available cash resources

- Includes the use of existing cash resources and outside financing

- Typically completed *before* the start of a new fiscal year, and usually is done over several years

- Items included in capital planning:
  - Building projects
  - Building infrastructure maintenance
  - Building infrastructure break/fix
  - Technology infrastructure
  - Technology development

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Composite Score

- **<u>Composite Score Ratio (CSR)</u>** – For institutions that participate in federally funded student financial aid programs, the CSR demonstrates financial responsibility and relative financial health

- CSR is calculated based on components of an institution's financial statements and summarized in three ratios
    - Primary Reserve Ratio
    - Equity Ratio
    - Net Income Ratio

- CSR Scores range from -1.0 to +3.0
    - Passing – score 1.5 or greater
    - In the zone – score between 1.0 and 1.4
    - Failing – score below 1.0

Composite Score

1. **Primary Reserve Ratio** – measures an institution's financial health by comparing its expendable net assets to its total expense

   How long can an institution operate using its expendable reserves without generating additional net assets from operations

   $$\frac{\text{Expendable Net Assets}}{\text{Total Expenses/Losses}} \quad X \quad 40\%$$

2. **Equity Ratio** – measures an institutions capital resources and its ability to borrow

   Measures financial stability and credit worthiness

   $$\frac{\text{Modified Net Assets}}{\text{Modified Assets}} \quad X \quad 40\%$$

Composite Score

3. **Net Income Ratio** – measures the revenue contribution toward growth of unrestricted net assets

Measures the ability of the institution to generate revenues/gains in excess of expenses

$$\frac{\text{Change in Unrestricted Net Assets}}{\text{Total Revenues/Gains}} \quad \text{X} \quad 20\%$$

Composite Score

Composite Score = Ratio X Strength Factor X Weight

- The "Strength Factor" reflects how strong or weak a school is in a specific area of financial health
  - Cannot be higher than 3.0
- Weighting reflects the importance of each ratio in determining an institutions financial health

SOA	Expendable Net Assets.......................	$500,000
	Total Expenses/Losses.......................	$1,500,000
	Total Revenues/Gains.......................	$1,750,000
SFP	Modified Net Assets...........................	$1,650,000
	Modified Assets................................	$1,750,000
	Change in Unrestricted Net Assets....	$10,000

							Ratio		Strength Factor				Weight		Composite Score
Primary Reserve Ratio	=	Expendable Net Assets / Total Expenses/Losses	=	$500,000 / $1,500,000	=		0.33	X	20	=	3.000	X	40%	=	1.200
Equity Ratio	=	Modified Net Assets / Modified Assets	=	$1,650,000 / $1,750,000	=		0.94	X	6	=	3.000	X	40%	=	1.200
Net Income Ratio	=	Change in Unrestricted Net Assets / Total Revenues/Gains	=	$10,000 / $1,750,000	=		0.01	X	(50 X Ratio)+1	=	1.286	X	20%	=	0.257
														TOTAL	2.657

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CFO Partnership

- **CFO ”Must-Haves”**
  - Aligned with the vision and strategy
  - Trusted advisor
  - Natural curiosity
  - Is a respected member of the management team
  - Communicates effectively
  - Ability to effectively focus on the future
  - Ability to influence decision making

- **CFO “Red Flags”**
  - Does not have your respect and/or the respect of the management team
  - Does not communicate effectively
  - Does not understand key drivers
  - Focuses on problems instead of solutions
  - Does not treat people with respect