Navigating the New Normal:

FINANCIAL IMPERATIVES FOR MSI EFFECTIVENESS AND AVOIDING FINANCIAL EXIGENCY

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EXECUTIVE SUMMARY

Serving on the board of any nonprofit organization has taken on added significance in recent years. There is greater accountability for trustees and for the overall mission and effectiveness of the organizations that they have the ultimate fiduciary responsibility to maintain. The changes have challenged not only the personal commitment that board members should have for the organizations that they oversee, but the changes also bring into sharp focus the competencies and skill sets that are necessary to oversee and set policy for their respective organizations. There is one key issue that usurps most higher education headlines, but is rarely discussed; financial exigency, and the policies, practices, and processes that might enable it.

Trustees are now awakening to the reality that they must have a greater understanding of the finances of the institutions they oversee. They cannot simply attend a one-day board training at their first meeting and fully understand all that is necessary for them to make wise and sound decisions around the financial health of the institution. Given the multifaceted nature of the revenue and expense elements of a college or university, trustees now have to ask themselves the tough questions: do I really understand the financial health of my institution, and how the decisions of the board are affecting it?

This brief provides some factors for trustees to consider, and explores some of the difficult issues that will affect Minority-Serving Institutions (MSIs) in the years to come. It is not intended to be an exhaustive listing of the issues, but will pique the interest of trustees to ask deeper and more probing questions about their institutions, especially in this time, post the Great Recession of 2008-2009.

The following are examples of probing questions that, when answered, can help trustees gain a more nuanced understanding of the financial health of their institution:

- What is the discount rate for entering freshmen versus the continuing students?
- What is the blended discount rate?
- How much is funded or unfunded institutional aid?
- What is the spend rate from the endowment on an annual basis?
- What is the Composite Financial Index score (CFI) for purposes of the Department of Education's Financial Responsibility Test?
- What percentage of total revenue is from tuition, fees, room, and board versus unrestricted annual fundraising?
- What are the tenets of the bond covenants that must be met each year from annual operations?
- What is the debt level of the institution and how much is paid out annually towards this debt?
- What is the value of the Unrestricted Net Assets, Net of Plant, and Plant-Related Debt?
- What is the size of the unrestricted endowment at the institution?
- How many lines of credit are being accessed by the institution, and what are the annual costs associated with these lines of credit?
- What were the substantive issues raised by the auditors during the last audit? How are they being addressed?

These questions only scratch the surface of the knowledge base that trustees of higher education institutions need to understand in the context of the financial health and exigency of their institutions.

This brief includes an exploration of these tenets and concludes with some examples of what trustees can do to address some of the issues that are common place within the industry post the Great Recession of 2008-2009.

This brief also highlights the need, and provides strategies, for engaging boards of trustees in new and reinvigorated training on the major financial variables that impact institutions of higher education. As university administrations are tasked with training new board members, such instruction needs to extend to more detailed approaches around the finances and administrative aspects of the institution's operations.

Finally, the brief includes some of the changing demographics that are requiring a shift in how boards and administrations must look at the diversification of the pool of potential college students. Although the negative variables that are currently being experienced in higher education impact almost all institutions, for MSIs, the challenges are more acute because of the financial histories of the institutions and the demographic of students they primarily serve. For that reason, training and development for trustees are now more critical than ever in order to extend MSIs' storied histories and legacies.

The listing is not conclusive; however, new and innovative approaches to higher education financing and financial management are necessary because relying on historical student demographics and students' ability to pay will be to an institution's detriment. This list has limits but does provide innovative options for financial solvency that are diverse and often more reliable than tuition alone.

This brief is a guide to equip MSI board of trustee members with strategies that will help them become acutely aware of, and engaged in the financial future of their institutions. The old cliché that says, "trustees should have their noses in, and their fingers out" in terms of their role in the organization is a truism that must be respected. The president is the chief executive officer of the institution; however, constant monitoring and asking challenging questions are necessary to ensure that their fiduciary responsibilities are met. Trustees who are competent in the financial tenets of the institution are better partners to the president and better equipped to oversee the school's mission.

PRACTICAL STEPS FOR BOARDS AND ADMINISTRATIONS

1. Create an enrollment strategy that takes into consideration both the changing demographics in the United States, and the ability of students to pay.

2. Hire qualified and experienced business analysts (preferably with a statistical background) into the enrollment management group to ensure that statistical analysis and modeling informs the framework for enrollment and retention projections. If the institution cannot afford to hire a full-time business analyst, they should seek the services of a reputable firm to contract a part-time business analyst. If possible, invest heavily in a strong and robust business intelligence (data warehousing) platform to generate accurate information to make decisions.

3. Understand the operating cash flow needs of the college to assist with shaping the institutional aid programs. Do not simply attempt to meet enrollment goals, but make sure that despite the size of the institution the "net tuition revenue" is positive to cover the operating budget. Deficit spending and other financial stress-related approaches should be of a last resort.

4. Engage with fundraising consultants who can assist with market analysis and surveys to support establishing benchmarks around fundraising for both annual goals and capital campaign goals.

5. Train the institutional advancement staff to understand the hierarchical needs of fundraising, and how they work in tandem with the budget office to manage both expectations and results.

6. Engage with seasoned financial officers from the higher education sphere to conduct training workshops for the board of trustees. An in-depth discussion of the institution's financial health and challenges should be the focus of at least one board of trustees meeting during the year.

7. Create a timeline for board review of the financial and OMB A-133 audits, and the IRS Form 990.

8. At the beginning of the year, review cash flow projections that highlight unrestricted and restricted sources

Glossary of Terms

Financial Exigency- a situation where an institution is financially challenged to the point that its existence is threatened.

Financial Responsibility Test – an annual calculation of ratios that create a Composite Financial Index (CFI) as determined by the Department of Education. The results of the test and the attainment of a baseline score will determine whether an institution remains in the Title IV program.

Full-Time Equivalents – total amount of students who will be paying full-time tuition and fees. The effects of part-time students are factored out in order to provide an accurate picture of how much revenue student enrollment credit hours will generate for the institution.

Funded Institutional Aid – scholarships provided to students from institutional sources such as long-term portfolio interest gains, or gifts solicited from donors for scholarships. These are managed through the enrollment management group of the campus, but normally have donor restrictions associated with them.

Gross Tuition Revenue – total amount of revenues received from an institution before scholarships and other institutional aid. It is calculated by multiplying the total number of full-time equivalents of enrolled students by the tuition and fees. This does not include revenues from room and board (e.g. meal plans).

Headcount – total number of individuals who have enrolled at the institution. It does not take into account the difference in credit hours to be taken by students. One student represents one in the headcount.

Net Tuition Revenue – total gross revenues from tuition and fees only, net of institutional aid provided to students in the form of scholarships. It is typically the largest source of revenue for budget balancing purposes of an institution.

Unfunded Institutional Aid – institutional scholarships provided to students that do not have a source of cash. It is a discount on the price of attendance. They are usually provided in two main categories: merit aid and need-based aid. This pool of funds is managed through the enrollment management group on the campus.

Unrestricted Net Assets, Net of Plant, and Plant Debt – the value of an institution's unrestricted net assets adjusted for the value of the physical plant, and the debt related to said physical plant. This provides an indication to the trustees and administration as to the value of the unrestricted net assets that can be utilized without having to liquidate or sell portions of the physical plant.

An Introduction to the MSI Financial Landscape

When the price of gasoline rose above $3 per gallon, many people inaccurately predicted that it was a passing phase, and that prices would return to previous levels. All of the current indicators seem to suggest, that like the price of gasoline, the recent increases to the higher education cost structure are permanent. The most obvious example of a change is the process that unfolded regarding heightened regulations for the Parent Plus Loan program instituted by the Department of Education in the summer of 2012.

As well intentioned as the changes were, they had a consequence that could have been foretold by Minority-Serving Institutions (MSIs) if they were consulted. The department changed the credit requirements for parents to get these loans for their children, thereby disproportionately impacting MSIs who enroll a significant proportion of low income, first-generation college students. In the year following the Parent Plus Loan changes, HBCU Parent Plus Loan approvals decreased by 36%, resulting in a $150 million dollar reduction in annual HBCU funding. [1] Additionally, some estimate that HBCU enrollments have dropped by nearly 10%, with 38,000 students leaving campuses because of the Parent Plus Loan changes. [2] Given the very slim operating margins they have, such an impact had to be met with prudent adjustments. The impact of the federal changes to the Parent Plus Loan requirements were also conflated with state level changes that included legislative mandated budget cuts and tuition increase caps. Together, these issues placed considerable financial pressure on MSIs and contributed to the declines in enrollment that followed.

Boards and administrations responded in ways that often meant reducing expenses to match the lower revenues. The Department of Education recently approved new guidelines for the program, that include clearly defined parameters for eligibility, but the previous criteria for borrowers was not reinstated in its entirety. Consumer advocacy groups have joined the debate and underscored the potential harm that Parent Plus Loans can have on low and middle income families. With the debate yet to be resolved, trustees at MSIs are now being called upon to assist administrations in achieving the mission of their institutions in ways that might not typify past board behaviors.

The current Parent Plus Loan matter is not the only issue that represents a major threat to MSIs. The following are other factors that boards and other MSI leaders must face in the current higher education environment: changing demographics, unpredictable economic circumstances, federal and state governments' reduction in support, small endowments, increased competition with other institutional types that includes the expanding for-profit college and university sector, and lackluster fundraising success are all facets that contribute to financial challenges at many MSIs.

Tough choices are on the horizon for these institutions because in years past, these variables could be considered a passing storm, but in today's higher education sphere they are likely here to stay.

The results are financial hardships that can lead to the closure of culturally significant campuses like National Hispanic University. Thus, MSI boards and leaders are challenged to make critical decisions that will require courage, vision, and tenacity.

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1 - Anderson, N. (2013). Tighter federal lending standards yield turmoil for historically black colleges. Washington Post.

2 - Blumenstyk, G. (2014). Negotiators wrestle with how to revise rules for PLUS loans. The Chronicle of Higher Education.

Affordability and Institutional Finance

ENROLLING LOW-INCOME, STUDENTS OF COLOR

The National Bureau of Economic Research reports that, "…among the individual and family background characteristics, only race is consistently important for all measures of [student loan] repayment/nonpayment. Ten years after graduation, black borrowers owe 22 percent more on their loans, are nine percentage points more likely to be in default (nonpayment), have defaulted on 11 percent more loans, and are in nonpayment on roughly 16 percent more of their undergraduate debt compared with white borrowers. These striking differences are largely unaffected by controls for choice of college major, institution, or even student-debt levels and post-school earnings." [3]

With the cost of a postsecondary degree rising faster than the rate of inflation, and an unstable job market students and parents are rethinking college costs and spending. If this trend continues, institutions will find it increasingly difficult to attract students who can afford to pay tuition. Nationally, "…where younger age groups get bigger, people are poorer: Of about 450 counties with significantly more younger children than older ones, about 330 have median incomes below $50,000, compared with a median of $52,762 nationally." [4] The cost of attendance at some private MSIs is above $20,000 per year, with variations based on name brand and recognition.

The question is whether such price tags can be sustained when the majority of MSI students come from working class families.

3 - Lochner, L.J., & Monge-Naranjo, A. (2014). Default and repayment among baccalaureate degree earners. Cambridge, MA: The National Bureau of Economic Research.

4 - Lipka, S. (2014). Demographic data let colleges peer into the future. The Chronicle of Higher Education.

This dilemma should force MSI boards of trustees and administrators to focus heavily on both affordability and effectiveness. In 2013, two small private liberal arts colleges decided to step outside the box to take a look at the affordability of their institutions. In a 2013 Chronicle of Higher Education article titled "Colleges Slash Tuition, Raise Hopes," a trustee at Converse College said, "In higher education, sticker prices have been used to signal quality. But the high-tuition, high-aid model becomes more and more difficult to execute the further up the tuition-discount scale you go." The president of that same college also shared that in the future, "…price will be tied to growth in operating costs, not the need to cover a growing discount rate." It is necessary to consider how many institutions can and will follow this trend to resist a high-tuition, high-aid model, and instead connect price to operating costs.

Moving away from high-tuition, high-aid models is important for institutional effectiveness and also begins addressing the challenge of attracting and enrolling students with fewer resources for tuition. The effect of adjusting these two variables is a psychological one because the true impact of this model versus others is that "net tuition revenue" must remain positive. It is all about how much a family will have to pay out of pocket to have a college experience. Dropping the tuition sticker price and reducing the amount of aid provided by the institution creates an illusion that a college or university is cheaper to attend, but the out of pocket payments may not change. This concept is explored in detail below.

Further, MSIs are also competing with Traditionally White Institutions (TWIs) that have, as one of their goals, to diversify both the student body and faculty. MSIs are faced with the challenge of attracting African American and Latino students, who are academically gifted and motivated, and now have more college choice options than in the past. Therefore as four-year TWIs strengthen their diversity programs, enrollment of students of color at MSIs correspondingly decreases because the pool of potential college students is a variable that is not controlled by any one institution. For example, when the Gates Millennium Scholars Program was officially launched in 1998, it was a watershed moment in higher education scholarship funding. To address the underrepresentation of minorities in certain academic disciplines, Bill and Melinda Gates pledged 20,000 scholarships for minority students to attend any institution of their choice, with the program geared toward Pell Grant eligible students (i.e. students with socioeconomic challenges). Although the program was administered by the United Negro College Fund Inc., the majority of its member schools did not have much success in attracting these highly talented and motivated students who require their last dollar of need being

met in order to enroll into the college of their choice. They primarily opted for TWIs that had programs that suited their interests. As programs like the Gates Millennium Scholars target students of color and provide them access to any school in the nation, MSIs are further challenged to attract and enroll the best and brightest to their campuses.

MSIs have to compete for students of color in the higher education landscape that includes a diverse set of institutions. In addition to asking those affordability and effectiveness questions, boards have to put it in the context of their strengths as MSIs by asking; how do we capitalize on our strengths of producing a significant proportion of the degrees awarded to students of color? For example, in 2011-2012, MSIs awarded certificates and degrees to nearly 250,000 Black, Latino, and Native American undergraduates, representing 40 percent and 21 percent of the total credentials awarded to Latino and Black students respectively.[5] Further, HBCUs, as less than three percent of all institutions of higher education, produce 17 percent of the Bachelor's and Doctoral degrees awarded to African Americans, 25 percent of the Bachelor's degrees in Education and 22 percent of the Bachelor's degrees in STEM awarded to African Americans.[6] It is critical to the financial future of MSIs that institutional leaders consider how to promote their track record of providing opportunity to and cultivating the success of underserved groups to prospective students and families.

In addressing issues of institutional effectiveness and affordability, trustees will be challenged to utilize diverse skills that include financial creativity, and social influence. As noted in the March 2014 Chronicle of Higher Education article, "Financially Strapped Colleges Grow More Vulnerable as Economic Recovery Lags", in regards to small, private institutions, a representative from Moody's credit rating service was quoted as saying: "Either they haven't been paying attention to the market as it's changing around them, or they have strategic goals that are inconsistent with who they are." Hence, boards of trustees have to answer the following questions: where are we going to find students who meet our academic standards and can afford to pay to attend? If our tuition prices remain stagnant or decrease, how can we respond to inflationary increases associated with other costs like much needed capital maintenance of the physical plant? If we have residence halls, and we say we are a residential campus, what strategies need to be in place to garner room and board revenues? Finally, how can we ensure that financial adjustments are not made at the expense of educational quality and provide a high quality education at an affordable cost? Boards must remain financially competent if they want to have informed answers to these questions.

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5 - Cunningham, A., Park, E., & Engle, J. (2014). Minority-Serving Institutions: Doing more with less. Washington, D.C.: Institute for Higher Education Policy.

6 - Lee, J. M. & Keys, S. W. (2013). Repositioning HBCUs for the future: Access, success, research, & innovation. Washington, D.C.: Association of Public and Land-Grant Universities

TUITION MODELING

Tuition modeling is a broad concept intended to ensure institutions achieve positive net tuition revenue by examining key cost and revenue variables over an extended period of time. Net tuition revenue is calculated by taking gross revenues from tuition and subtracting expenses like institutional aid.

The tuition modeling process requires institutions to take into account variables like headcount, full-time equivalents (FTE), tuition discounting, annual tuition, government loan programs, and overall economic climate. The combination of these variables is then modeled over a five to ten year period to determine the true value of the net tuition revenue. Having an understanding of the net tuition revenue is also important to providing an accurate understanding of the cost per degree. For example, it will be important for boards of trustees to know what it costs for a business degree versus the costs for a sociology degree. This information can provide board members with an understanding of which programs and departments are generating revenue, which is key to financial planning for the institutions.

Figure 2.1 Tuition Modeling

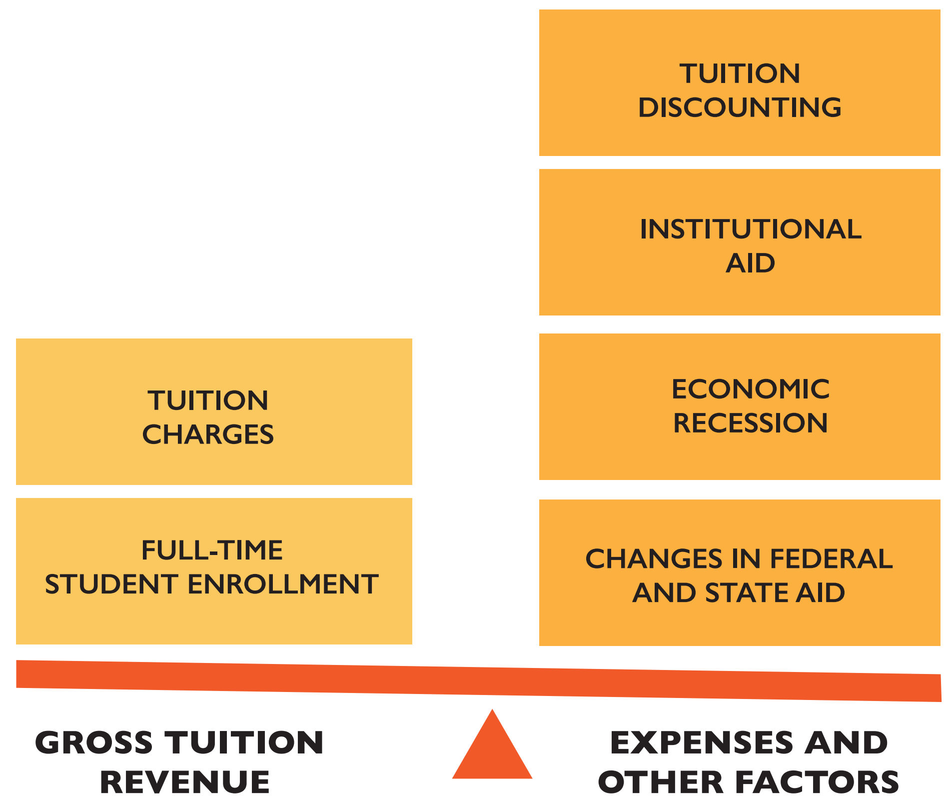


Figure 1.1 Calculating Net Tuition Revenue

The economy remains sluggish. This means most students and parents cannot afford to budget for college. As a result, the total operating budget for some higher education institutions is being impacted by the inability to generate positive net tuition revenue.

Consequently, colleges are choosing to maintain enrollments by providing unfunded institutional aid to attract prospective students who are unable to pay the full cost of attendance. Distributing unfunded institutional aid lowers the net tuition revenue if gross tuition revenue is flat or decreasing. Institutions often respond by reducing expenses in order to equal the net tuition revenue and balance their budgets. The lower the net tuition revenue, the more expenses must be reduced. This has resulted in a number of institutions having to lay off personnel, institute furloughs, freeze non-salary expenditures, and as a last resort, cut academic programs.

The table below is an example of an institution that has to balance its cost to the students, while at the same time, increasing institutional aid to maintain enrollment, and also managing the increasing number of students who can only afford to attend school part time. Although this is a gross simplification of the calculation, it provides some insight into what boards of trustees need to understand.

Net tuition revenue is the primary source of revenue for a higher education institution that is heavily tuition dependent, and managing this critical aspect of the overall operations falls to the enrollment management team of the institution. More specifically the Admissions and financial aid offices become extremely important for both attracting and enrolling students. These two departments are critical to an institution's financial stability, thus it is necessary to staff these offices with experienced and capable individuals who understand the very minute details of the intricacies of enrollment management and its impact on the financial health of the institution.

Vagaries in annual enrollment trends can wreak havoc on strategic tuition plans for a number of higher education institutions. From year to year, many small to medium sized campuses don't know who will show up because of financial shortfalls, academic probation, or other matters. Boards must examine the cost of attrition, more specifically, the financial costs to the institution when students do not show up or leave the college or university. Financial planning is difficult because the variables that go into the tuition models are challenged by a combination of external factors. For example, when looking at the tuition costs of one private HBCU, it is possible that a student who is eligible for the full Pell Grant, and has received all the federal loans available to low income students as determined by their EFC (Estimated Family Contribution) score, could still need an additional $6,000-$8,000 to meet the cost of attendance for one full academic year. Families that MSIs attract often find it difficult to pay the remaining tuition balance, hence campuses must find ways to provide additional aid to these students in order to secure their enrollment. Although distributing institutional aid in this way is a common practice, it is important for board members to question whether their institution can afford to continually increase institutional aid, at the risk of reducing the net tuition revenue.

Sample Net Tuition Calculation

DESCRIPTION	2014-2015	2015-2016	2016-2017
Tuition	$27,000	$27,810	$28,644
Gross Tuition Revenue	$20,250,000	$21,079,980	$22,056,111
Less: Institutional Aid	$5,000,000	$5,500,000	$6,000,000
Net Tuition Revenue	$15,520,000	$15,579,980	$16,056,111
Tuition Discounting %	24.7%	26.1%	27.2%
Total Headcount	800	825	850
Part Time Students	65	70	72
Full-Time Equivalents (FTE) on credit hours	750	758	770

The net tuition revenues and tuition discounting rates of a national sample of more than 150 higher education institutions were reported in the 2013 Noel-Levitz Tuition Discounting Report. In the report, institutions were classified based on size and tuition level. Small colleges with low tuition were defined as colleges with a tuition and mandatory fee rate of less than $25,000 and enrollment of less than 850 full-time, first year students. Small colleges with a high tuition were categorized as colleges with a tuition and mandatory fee rate of more than or equal to $25,000 and enrollment of less than 850 full-time, first year students. Most HBCUs and other MSIs are a combination of the Noel-Levitz's definitions of small colleges with low tuition, and small colleges with high tuition. According to the report, the average tuition discount rates for freshman students was 50.3% for small colleges with low tuition, 51.4% for small colleges with high tuition, and 43.2% for large colleges and universities. On average students receive a 50% discount on the cost of tuition. [7]

Although tuition discounting can have positive impacts on enrollment, boards need to refocus on "net tuition revenue" for balancing the operating budget, and question the practice of rapidly raising the discount rate to simply maintain enrollment. Snapshots of the actual budget, and how that financial aid is deployed become extremely important. If possible, boards should be asking for 1) net tuition revenue estimates based on the overall budget, and 2) the net tuition revenue per student in each budget planning cycle. These indicators will provide clear signs of whether the institution will have sufficient and adequate cash flow to operate versus simply meeting a predetermined enrollment total. Further, the discussions about tuition discounting and net tuition revenue should inspire more dialogue about campus approaches to institutional aid, sources of institutional aid that include funded and unfunded, and how institutional aid impacts the net tuition revenue.

INSTITUTIONAL AID

Campuses provide institutional aid to students who otherwise could not afford the cost of attendance. Funded institutional aid is primarily garnered from two sources: income streams from long-term portfolios (i.e. endowments) and annual fundraising gifts that are restricted to scholarships for students. For this aspect of a college or university's operations, its

7 - Noel-Levitz (2013). Tenth annual comparative research study. Discounting report: Comparative benchmarks from Noel-Levitz client institutions.

institutional advancement office plays a key role. If there is not the presence of a large endowment to produce annual returns to assist with scholarships, or the annual fundraising for scholarships is dismal, the institution is left with only unfunded institutional aid to attract, and more importantly, retain its students. Unfunded institutional aid is not a cash award; rather it is a discount on the cost of education a student must pay to attend an institution. This is a key point for trustees to understand because this form of institutional aid does not provide much needed cash to the institution. They have to be mindful that although this will give the impression that enrollment targets are met, the underlying finances of the institutions are placed at risk if this is not managed in a strategic manner where "net tuition revenue" remains positive. This is where a clear understanding of tuition modeling is a very important concept. Because MSIs face risks associated with awarding unfunded institutional aid, securing additional sources of funding is critical.

Fundraising and Operations

The Council of Advancement and Support of Education (CASE), survey results indicate that fundraisers are cautiously optimistic for 2014, but they believe there are factors that continue to impact donor confidence. It is important to consider national sentiments about fundraising in the context of MSIs. The former president of the United Negro College Fund, the late William H. Gray III, said, that fundraising is not a panacea that will solve all the challenges that our institutions face. Fundraising won't solve all problems at MSIs, but it is essential for institutions to understand the role of fundraising in annual operations, and the critical need for unrestricted gifts versus restricted gifts. Frederick D. Patterson recognized this need in 1944 when he called HBCU presidents together to form the United Negro College Fund, to assist these campuses in gaining critical unrestricted operating support through collaborative fundraising campaigns.

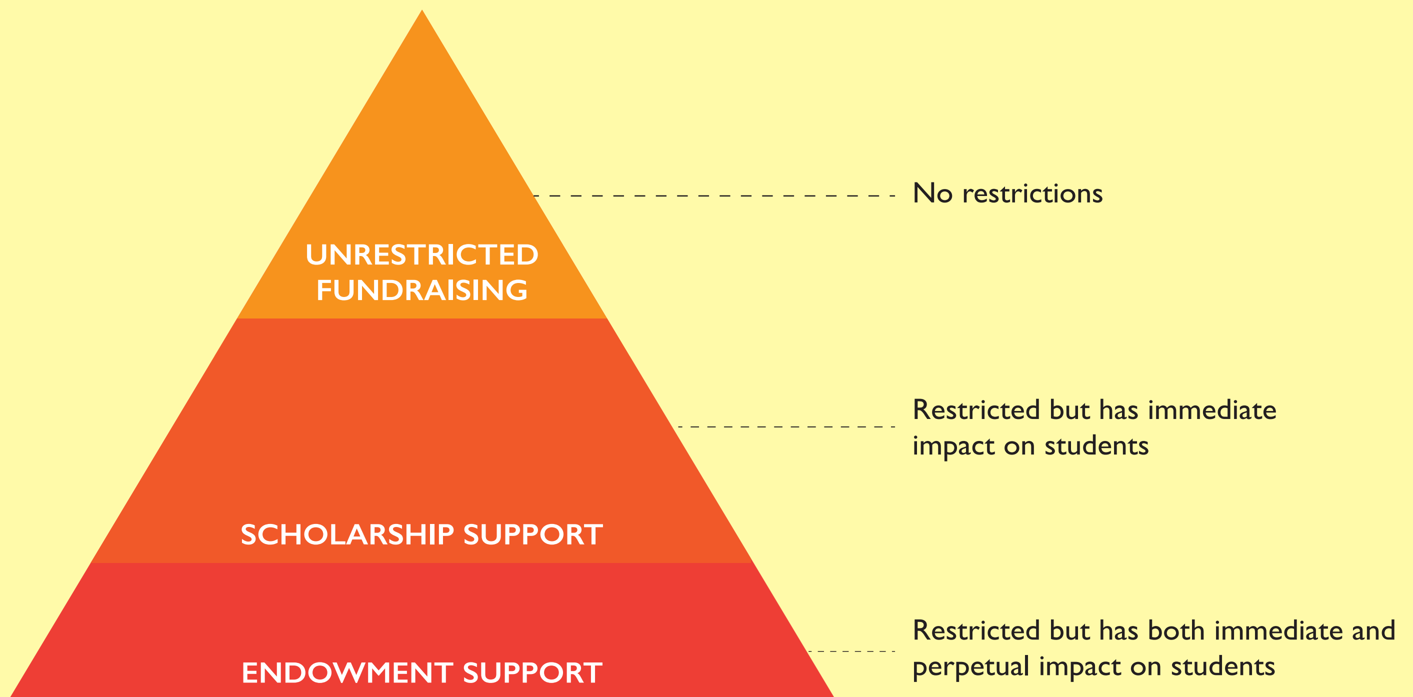
So goes the economy, so goes fundraising. Fundraising in higher education has not been immune from the challenges that all nonprofits are experiencing. The Great Recession of 2008-2009 exposed just how reliant institutions of higher education were (and still are) on fundraising. They need unrestricted sources of revenue, or targeted endowment and annual gifts to augment budgets. If they are unable to garner unrestricted sources of funds, they need to attract restricted funds that feel unrestricted. In other words, if pure unrestricted funds are not garnered, budget and cash flow relieving gifts are just as good. Examples include gifts to the physical plant and scholarships. Boards now need to engage development offices with a strategy toward bridging this gap, and develop meaningful and realistic timelines that can be managed.

EFFECTIVE FUNDRAISING

First, fundraising efforts must follow a hierarchical structure with unrestricted dollars being the main source of all efforts. However, there is a shift in donor preferences to restricted giving, and except in the case of scholarships, restricted funds do not have the same impact as unrestricted giving. For example, brick and mortar (physical plant) gifts no longer carry as much weight in campaigns, as donors are now more program-specific with their contributions. Specific donor restrictions limit institutions' capacity to meet their current needs.

Secondly, fundraising efforts should be tied into a formal strategy. It is in this context that boards can assess whether or not to accept contributions from donors. Chief financial officers know that not all fundraising is good. That is because some gifts have conditions that are not supported by revenue sources and are often restrictive. This occurs sometimes with grants that establish programs on campuses, but do not materialize into what was originally expected. Either way, the institution has to roll those costs into its operating budget without any revenue offsets. Institutions must also become smarter about determining how much accepting a gift will cost them (e.g. infrastructure, maintenance, etc.) in the future.

A UTOPIAN FUNDRAISING HIERARCHY



SETTING FUNDRAISING TARGETS

Donors who are committed to the mission of an organization are like molasses. Their giving is slow and steady. Years are spent on donor cultivation, where the donor is engaged in the institution, and ultimately develops an understanding of how he or she can contribute to the manifestation of the institution's vision. Fundraising initiatives are tied around strategic plans and visions where disparate groups of individuals can coalesce to make a lasting difference.

Currently, MSIs do not have many of these "molasses" donors. Some institutions are in very fortuitous positions of being written into the wills of wealthy individuals who have set aside assets that earn funds in perpetuity. Many are still supported by religious organizations, but not at the same funding levels because of competing priorities. Therefore, boards need to recognize this fact, and set realistic targets for fundraising on an annual basis. Strategic planning should address five- to ten-year horizons. There is no set percentage of fundraising a board can establish, but it underscores why boards of trustees need to remain engaged on this topic, and, more importantly, be realistic about what can be achieved on an annual basis.

In fundraising campaigns, nothing is more exciting than imagining what the campaign will look like and what it will fund. It is during the planning process that reality needs to be assessed. In the midst of the planning process there has to be a holistic discussion about the cash flow needs of the institution and the importance of managing the core operating budget. Shifting an institution's core operating budget from tuition, fees, room, and board to unrestricted fundraising, may leave the organization operating from a standpoint of fits and starts. When an institution is too dependent on unrestricted fundraising for the core operating budget, operations may suffer because gifts can be unpredictable and episodic in nature. Boards and administrations must remember to temper their enthusiasm somewhat to ensure that what is proposed can be sustained, especially if key operational aspects of the institution are tied to achieving fundraising targets. If not, it should be discussed robustly before the institution embarks on such a path. Maximizing revenues and efficiencies through proper management will always produce more predictable revenue streams than waiting on a donor to make good on a contribution. Boards should be reminded of the qualifier that brokerage houses ensure their clients understand, "past performance is no guarantee of future results." Additionally, board members should also remember their dual role as investors and solicitors when supporting fundraising campaigns. It is critical that board members demonstrate their support of, and commitment to, the institution by making investments and actively seeking out new donors for the institution.

MANAGING PLEDGES VERSUS CASH

"I'll gladly pay you Tuesday for a hamburger today." This often repeated bargain from the cartoon character Wimpy, sums up what has transpired in fundraising since 1996 when the Financial Accounting Standards Board (FASB) adopted Pronouncements 116 and 117. These two pronouncements were adopted to bring consistency to financial reporting around contributions and their disclosure in financial statements. They standardized the reporting of contributions, both pledged and received. They mostly eliminated the concept of deferred revenues that took away the ability of nonprofits to manage their pledged contributions over several years. In summary, FASB Pronouncement 116 required nonprofits to record both pledged and received contributions and gifts in the year which they are received. Like Wimpy, donors can make pledges immediately to organizations and also make payments in the future. The practice is harmless except when organizations record those pledges as revenue in the year the pledge is made. This records the revenue from the pledge and establishes an asset that the organization tracks into the future for collections (i.e. accounts receivable).

Board members should bring a unique perspective to this discussion in their role as ultimate fiduciaries. The same focus that surrounded the receipt of a pledge (especially if it is large) should be the same around future collections. Revenues for the year of the pledge might be great, but unlike "easy money" if it is not consistent, the financial statements of the college will go through a sporadic routine year after year. Revenues are one thing, but the cash needed to operate from the pledges are not available until in the future. Where does the institution get the necessary cash to pay bills? The donor gets instant recognition in the annual report as a contributor, but the institution still must pay bills into the future until the cash payments are received.

This is an extremely sensitive topic for many boards because they want to see a multiplicity of gifts, but if they are restricted, or are pledged for long periods of time, the institution still has to find resources to cover the payments in the interim through its core operations. Boards cannot divorce the Statement of Activities from the Balance Sheet. They are related, and they carry equal weight. Heavy focus should also be given to the Statement of Cash Flows.

If these statements seem foreign, it suggests that as a board, some work must be done to better understand the institution's cash flow and overall operations.

"Boards should be asking for 1) net tuition revenue estimates based on the overall budget, and 2) the net tuition revenue per student in each budget planning cycle.

These indicators will provide clear signs of whether the institution will have sufficient and adequate cash flow to operate versus simply meeting a predetermined enrollment total.."

Financial Management

The number of degree-granting colleges that failed to meet the U.S. Department of Education's financial responsibility test has increased. Additionally, "…the scores are one of the few public indicators of private colleges' financial health… colleges that get failing scores sometimes close or are sold soon afterward… the 2012 data show at least three colleges with failing scores that have merged, closed, or will soon do so." [8] This quote underscores the fact that change is upon the higher education industry in ways that many are still coming to terms with. The chief lesson of the Great Recession is that constant change is the new norm. It will require new ways of thinking, creative ways to solve problems, and engaging with new constituent groups in more transparent and meaningful ways. Trustees are being held to much higher standards and must respond in ways that mean spending more time understanding all operational aspects of the institutions they are charged with overseeing. The reporting format for the IRS Form 990, the Grassley Commission on Endowments, the changes to the 403(b) rules and regulations, new bond compliance reporting, etc., are all aimed at getting higher education institutions to be more open and businesslike in their operations.

In addition to discussions around policies and procedures, enrollment, fundraising, and the capital needs of the physical plant, it is critical for boards of trustees to also understand the financial health of the institution, and manage all finances in prudent and effective ways.
As boards, members cannot expect if they do not inspect.

8 - Blumenstyk, G., & Newman, J. (2014). More colleges fail controversial financial responsibility test. The Chronicle of Higher Education.

FINANCIAL RATIOS

The most effective way for boards to understand the finances of the institution is to have a keen sense of where the institution's financial ratios measure up to peer and industry norms. Federal regulators, banks, other creditors, and accrediting bodies all monitor these ratios, and given the standardization of financial statements, they are relatively easy to calculate, and they provide invaluable information.

The Department of Education has annual financial standards that must be met in order for higher education institutions to remain in the Title IV loan programs they offer. Those standards are captured in what the Department of Education calls its Annual Financial Responsibility Test. To pass the annual test, colleges and universities must have a Composite Financial Index (CFI) of a minimum of 1.5 points. Simply put, failing the test signals to prospective students that their attendance at a college or university might be a risk, because if the institution is not allowed to participate in the Title IV programs, student affordability diminishes.

A 1998 Government Accounting Office report stated, "Students at HBCUs make extensive use of these loan programs. Although HBCU students accounted for 1.9 percent of fall 1995 enrollments at all 2-year and 4-year public and private schools, they were awarded 3.5 percent of the total dollar volume of student loans under FFELP and FDLP in fiscal year 1996." Not much has changed today and institutions that lose accreditation, and subsequently lose their Title IV funding can attest to that harsh reality. In other words, without the Title IV

programs in place, potential students will not be able to afford attendance. To add insult to injury, institutions that fail this test are publicly noted in an annual publication. Students and their parents can then see whether or not their institution of choice is financially viable.

The Department of Education has provided for some flexibility by way of ranges, but the ultimate goal is to score above the 1.5 points minimum threshold. The scale is somewhat arbitrary, but boards need to understand the **criteria of the Composite Financial Index.** The criteria are as follows:

- **Attain a 1.5 and the institution passes the test** for the most recently completed fiscal year. Typically no action is taken by the Department of Education.

- **Attain between a 1.0 and 1.5 and the institution may be subject to some form of adverse action** which could potentially mean being placed on a "reimbursement".

That means the institution will have to provide evidence of funds needed, and the Department of Education will reimburse those amounts after evidence of expenditure is presented. This development is a slippery slope causing cash flow concerns at smaller institutions. This is because cash flows and operating margins are so small that the campus in general may feel some pain.

- **Score below a 1.0 and the institution faces the possibility of not being allowed to continue in the Title IV program.**

There is a book that a number of Chief Financial Officers refer to in terms of financial ratios, their management, and how to align budgets, strategic plans and financial results for the benefits of institutions. The book is titled Strategic Financial Analysis for Higher Education and was written by KPMG, Prager, Sealy & Co, and Attain. This book should be considered required reading for boards, especially for members who serve on the budget and finance committee. The following passage from the seventh edition indicates how financial discussions have evolved as the economy rebounds from the recent recession.

"The crisis that began in 2008 has caused governing boards to further examine higher education institutions' core governance and management practices. Boards and senior management are being challenged to effectively manage the institution's risks. These challenges, in turn, have required board members to request more information and reexamine the institution's governance oversight and processes. Without a comprehensive understanding of the risks inherent in an institution's activities within a risk framework, members of governing boards may not be in a position to understand those inherent risks. One of the basic questions recently asked of boards and senior management by various constituents is why no one evaluated significant strategic financial risks, and if they did, why did the evaluation not adequately identify the risks that resulted in challenges for the institution?"[9]

The short answer to the question asked was simply that many board members did not know, nor did they know the right questions to ask.

It should be noted that the same ratios (or variations) utilized by the Department of Education are utilized by banks when they want to extend credit, or monitor debt covenants. Accrediting agencies such as the Southern Association of Colleges and Schools (SACS) and the Middle States Commission on Higher Education utilize these same ratios. Learning the language of the primary reserve ratio, the debt service coverage ratio, the net income ratio, and the equity ratio should be second nature to budget and finance committees of boards and senior administrators. Further, the high borrowing, and sometimes high default rates associated with some MSIs should be monitored by boards of trustees, as loan default rates become a more central component of how the federal government monitors colleges and universities.

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9 - KMPG, Prager, Sealy &Co.LLC, & Attain (2014). Strategic Financial analysis for higher education.

MANAGING THE BALANCE SHEET

All too often, boards focus primarily on the operational budget of the institution to the detriment of the balance sheet. The two are mutually exclusive documents, but they are inextricably linked.

One does not make sense without the other, and post the Great Recession, the statement of cash flows is also gaining prominence in terms of financial oversight and management. It is good that there is revenue to cover the expenses, but how are those resources being deployed to cover the overall financial stability of the institution for the short, intermediate, and long terms? It is the responsibility of the board to understand how decisions taken in one year will affect the future.

The National Association of College and University Business Officers (NACUBO) has recently undertaken a project to revisit how the financial health of institutions is measured. The focus is on four key financial statement documents: the balance sheet, the income statement (statement of activities), statement of changes in resources, and statement of cash flows. In regards to the balance sheet, Craig and Menditto (2014) have stated that, "although corporate and governmental entities classify the balance sheet, with current assets generally representing amounts that will be used or liquidated within one year, such a distinction becomes problematic for higher education institutions because restrictions must be factored into the liquidity equation." [1] This focus brings to light the challenge with pledged gifts from fundraising campaigns where the corresponding cash is not on hand but ratios are bolstered due to the pledges in the year the gift is made. Even before this new review by NACUBO, accrediting bodies have tried to get institutions to focus on the balance sheet in more intentional ways. For example, temporarily restricted net assets are included in the Department of Education's Financial Responsibility Test, but they are excluded from the unrestricted net assets, net of plant, and plant-related debt (which is a key measure for accrediting bodies).

Institutions were reminded during the Great Recession about managing cash effectively, and to not utilize cash in ways that do not have realistic returns within a twelve-month period. Going into reasons for the use of reserves in ways that are not advisable will require much thought, and if decisions are taken to use such reserves, institutions must do so in a prudent manner and not engage in deficit spending. This requires discipline from boards and senior administrators to understand all ramifications.

It is now critical for boards to manage the balance sheet with the same veracity with which they manage the operating budget. There are many tools at their disposal, and organizations and agencies will assist with the calculations. For smaller sized private institutions, the Council on Independent Colleges provides a Financial Indicator Tool score for its members. The analysis is done for institutions utilizing common data sets from publicly issued documents, and is sent to institutions in a Microsoft Excel spreadsheet. It is easy to analyze the information and archive the spreadsheet for future financial strategic planning.

Accrediting agencies like SACS provide good guidance in its ten year accreditation review materials that can be reviewed in context. However, looking at Core Requirement 2.11.1 and Comprehensive Standard 3.10.1 gives institutions a framework for the calculation around the unrestricted net assets, net of plant, and plant-related debt and also trend analyses that are key for understanding what the institution has to address in the short, intermediate, and long terms. Institutional leaders also should not wait on the five- or ten-year accreditation cycle to conduct an internal fiscal review, as some issues will worsen if not addressed in a timely manner.

There are a number of financial peer reviewers who will assist institutions by doing the calculations for an institution provided they are not evaluating said institution. In the MSI Chief Financial Officer community are a band of brothers and sisters who all have the same goal to assist these institutions. Boards and senior administrators need to plug into that network and draw upon the experiences and expertise of these individuals. Understanding the liquidity within organizations, and attempting to model that out into the future is going to be one of the most critical exercises an institution will be required to do in the current environment.

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10 - Craig, K., & Menditto, S. (2014). Reporting reimagined. Business Officer.

STRATEGIC PLANNING AND BUDGETING

In the SACS accrediting standard 2.11.1, there is mention of the preparation of a budget that is adopted based on sound planning. It sounds simple, and there is no doubt that there was sound planning that was engaged in order to create the budget. However, one common challenge is whether that planning took into account a formal strategic plan. Institutions are always faced with the constant threat of enrollment changes, endowment losses, and spikes in expenditures. The Great Recession pointed that out in clear terms. Understanding the strategic vision that is laid out and adopted is key to boards, and they should ensure budgets and financial models that are passed align with those plans, and, more importantly, are realistic.

FINANCIAL STATEMENTS

Approximately two years ago, the language of audited financial statements took on a new twist for nonprofit institutions as requirements for 403(B) retirement plans became commonplace in order to mirror the requirements of its cousin, the 401(K) retirement plan. Terms like qualified and unqualified opinions were mentioned en masse as institutions tried to understand and explain why auditors were providing qualified opinions on the plans, when an unqualified opinion is what was needed. Boards were yet again thrust into the limelight as members were forced to learn what the changes meant, and how they impacted their institutions.

Financial statements are the primary documents that communicate the financial health of an institution. In the higher education sphere, these statements are critical for meeting the requirements of federal agencies, accrediting agencies, and creditor institutions. Board members need to be acutely aware of financial statements and what they mean. Even more pressing, with the changes in the IRS Form 990 that called for greater accountability of boards, boards must state that the form was reviewed before it was filed with the IRS. The same financial statements make up the facts and figures that go into that public document.

By law, the IRS Form 990 is a public document and can be demanded by individuals; however, with websites like Guidestar, the information is even more accessible. Therefore, as boards meet and approve audited financial statements, and the IRS Form 990, it should be understood that they are putting their seal of approval on the documents. As a collective group, the seal of approval is something they need to take seriously.

Higher education institutions that receive federal funds should produce annual financial statements within set times frames. In addition to the basic audited financial statements, institutions have to also submit OMB Circular A-133 audits to the Department of Education via a dedicated website. Like the basic financial statements, boards are also responsible for accepting these reports and having them filed in a timely manner. For institutions that have a June 30th fiscal year end, the report is due by March 31st of the succeeding fiscal year. If the institution has a May 31st fiscal year end, it is due by February 28th of the succeeding year. Failure to submit the OMB Circular A-133 audit can cause Title IV participation to be suspended until the appropriate documents are submitted. The importance of timely audited financial statements cannot be overstressed. Because boards are responsible for receiving annual audits, hiring and firing auditors, and voting to adopt financial statements, they are responsible for the institution's ability to file financial statements in a timely manner. Too often boards are not aware of this reality. Once again, serving on boards in this highly regulated environment requires both skill and acumen.

Board members should have a keen understanding of what various auditor opinions mean. For the non-trained trustee member, he or she might think that a qualified opinion denotes a "good" audit result. The opposite is the truth. A "good" opinion is one that is unqualified. Anything less than an unqualified opinion should enliven a discussion around what is taking place at the institution.

Obtaining a qualified opinion on the annual audit is frightening, but boards need to be even more mindful of what auditors refer to as a "going concern opinion." The term a "fourth paragraph" is used to soften the language in some regards; however, regardless of how it is worded, such a paragraph should invoke immediate action. What such a paragraph signals to the institution and the general public is that the auditors cannot obtain evidence to form an opinion on whether or not the institution will be able to continue as a viable entity for the next twelve months. Such opinions are not commonplace; therefore, boards will have to get a full understanding of what is taking place at their institutions if such language is presented. Getting a "going concern" opinion should not be a surprise to any board member. The underlying issues that trigger such a paragraph in the audit opinion would have been in existence for a number of years, but were not addressed timely and effectively. Catastrophic issues can also cause such an opinion in a one-year time frame. Even still, those catastrophic issues are big changes that occur, and should be discussed in an open and transparent way.

Practical Steps for Boards and Administrations

Below are some practical suggestions for boards and administrations to consider given the current landscape in higher education.

1. Create an enrollment strategy that takes into consideration both the changing demographics in the United States, and the ability of the students to pay. There are experts in this field of study who can assist institutions. Remember that one size does not fit all, and that each campus will have to do its own independent study rather than adopting what another institution was successful with. This is especially true for the diverse set of institutions that are categorized as MSIs.

2. Hire qualified and experienced business analysts (preferably with a statistical background) into the enrollment management group to ensure that statistical analysis and modeling forms the framework for decisions made around enrollment projections and attainment. If the institution cannot afford to hire a full-time business analyst, they should seek the services of a reputable firm to contract a part-time business analyst. If possible, invest heavily in a strong and robust business intelligence (data warehousing) platform to generate accurate information to make decisions.

3. Understand the operating cash flow needs of the college to assist with shaping the institutional aid programs. Do not simply attempt to meet enrollment goals, but make sure that despite the size of the institution that "net tuition revenue" is positive to cover the operating budget. Deficit spending and other financial stress-related approaches should be of a last resort.

4. Engage with fundraising consultants who can assist with market analysis and surveys to support the establishment of benchmarks around fundraising for both annual goals and capital campaign goals. Often times, the emotional aspects of perceived capacity are not realistic, and do not take into consideration the cash flow needs for current operations.

5. Train the institutional advancement staff so they understand the hierarchical needs of fundraising, and how they can work in tandem with the budget office to manage both expectations and results.

6. Engage with seasoned financial officers from the higher education sphere to conduct training workshops for the board of trustees. Board training should become a more structured event, and should last more than simply a day and a half. An annual immersion in the institution's financial health and challenges should be the focus of at least one of the meetings during the year.

7. Create a timeline for board review of the financial and OMB A-133 audits, and the IRS Form 990.

8. At the beginning of the year, review cash flow projections that highlight unrestricted and restricted sources.

“There are no silver bullet solutions to solving the challenges that higher education is currently facing; however, prudent measures and purposeful engagement of an iterative nature will allow for both boards and administrations to remain partners in keeping an institution viable into the future, thereby protecting it for future students to attend.”

ABOUT THE AUTHOR:

Gerald L. Hector, CPA is a graduate of Howard University. After graduating Howard, he was a public accountant with then-Deloitte and Touche where he specialized in independent power plants and utilities and nonprofit organizations. He left Deloitte and Touche to join William H. Gray III at the United Negro College Fund, Inc. as its Corporate Controller, where his accomplishments included helping to establish the financial framework for the landmark $1 billion Gates Millennium Scholars Program in 1998. He then joined Dorothy Cowser Yancy at Johnson C. Smith University (a UNCF member institution), where he accomplished many financial firsts for the institution that included the creation of its first unrestricted cash reserve of approximately $10 million and growing the endowment above $53 million, at that time the highest in the university's history. He was also a key member of the 2006 reaccreditation efforts where the university received zero recommendations.

He currently serves as Vice President for Finance and Administration at Ithaca College in Ithaca, New York, since July of 2013, where he oversees all finance and administrative functions of the college. He is a former Southern Association of Colleges and Schools financial reviewer, and presented at the Southern Education Foundation's annual MSI leadership meetings for two years. He has advised boards and presidents at HBCUs on financial-related matters.

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