



Ohio Department of Higher Education

2017 Board of Trustees Annual Conference

Institutional financial health: essential questions board members should ask

November 9, 2017

Agenda

- ▶ **Introduction**
- ▶ How financially sustainable is my institution today?
- ▶ How stable is my institution's revenue?
- ▶ Are my institution's expenditures aligned to revenues?
- ▶ How is my institution balancing its budget?

Introduction

The responsibilities of boards have never been greater

“A powerful, informed, and engaged board is essential for effective governance ... **their task is far larger than simply selecting the campus president or chancellor and then stepping aside.**”

– *American Council of Trustees and Alumni*

“At a time of rising costs, low graduation rates, and questions about students’ preparation for jobs ... **trustees in general are being criticized for being too complacent.**”

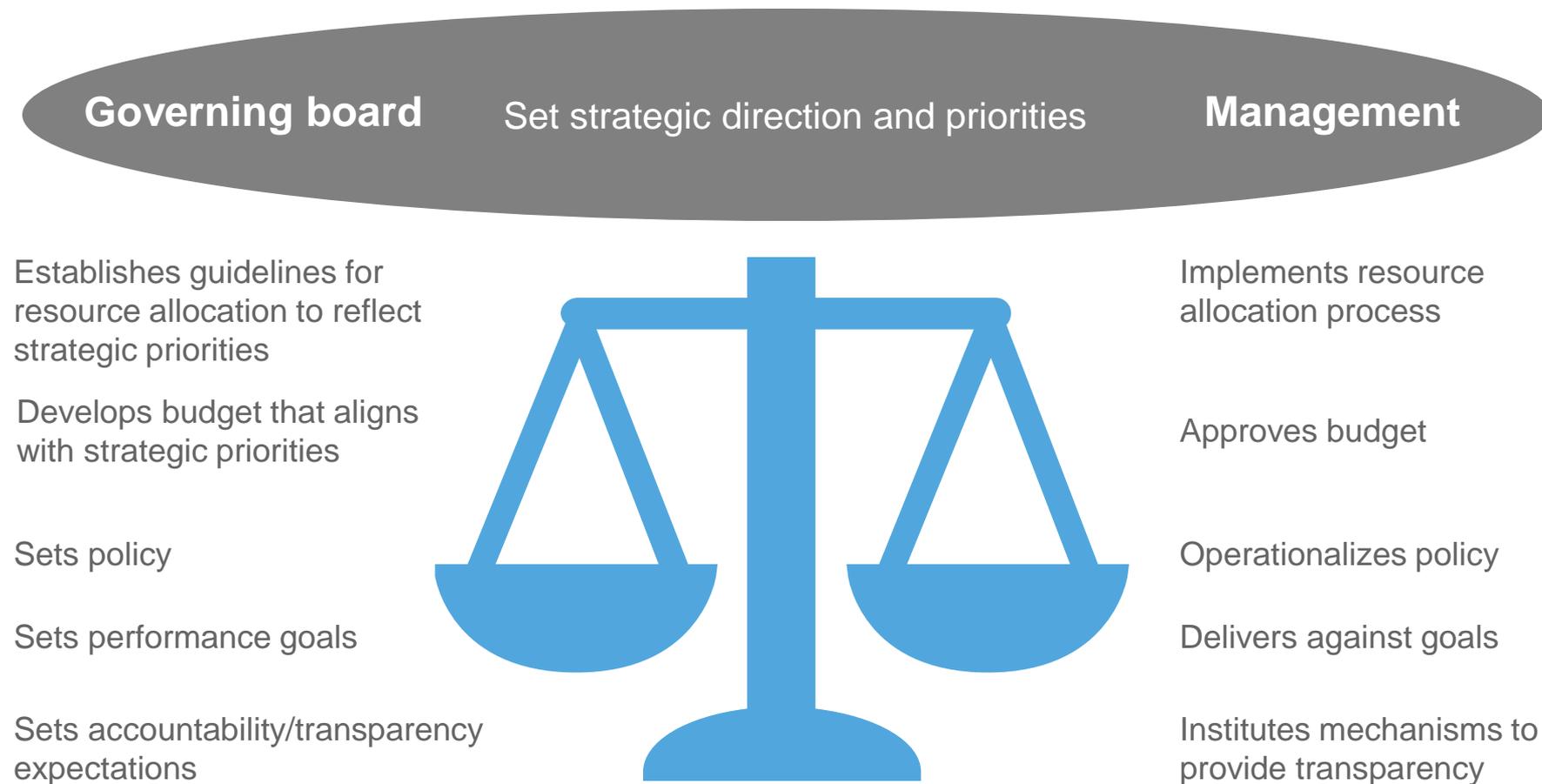
– *PBS NewsHour*

“Higher education must be reconfigured to recognize new student populations, altered educational delivery methods, basic changes in financing, and rising expectations from the public. **Boards must be at the forefront of those changes.**”

– *Association of Governing Boards of Universities and Colleges*

Introduction

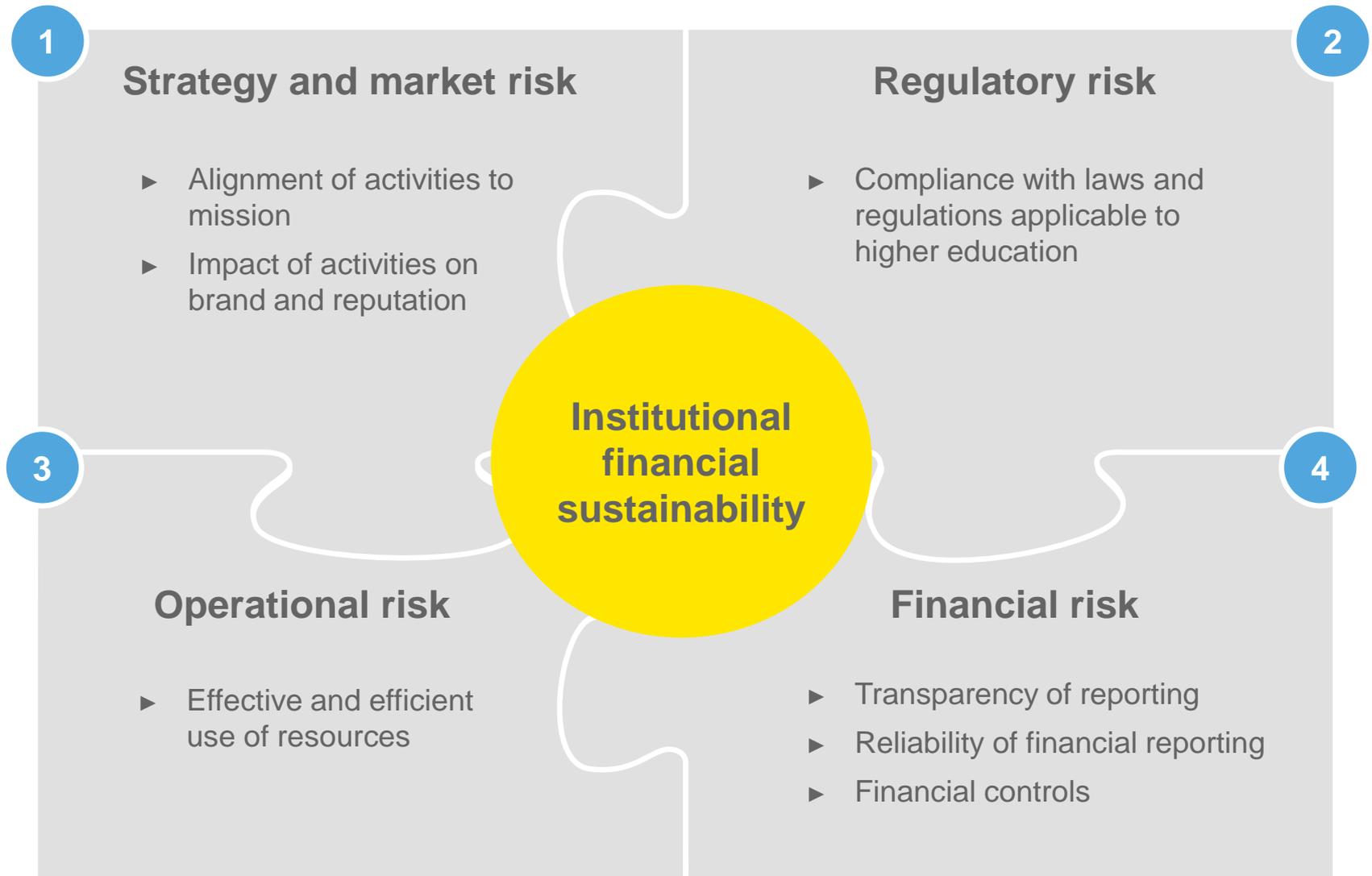
Governance is not the same as management; both need to work together. Boards must strike the right balance when asking questions of the institution and leadership



To ensure budget transparency and institutional financial health, questions board members ask need to balance the need for transparency with the right level of operational detail.

Introduction

Boards need to ask questions to assure themselves of institutional financial sustainability, but those questions cannot be asked in a vacuum



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How financially sustainable is my institution today?

Ohio's Senate Bill 6 looks at three key financial ratios to ensure institutions are held to a high level of financial accountability

Key questions	Financial ratios		Multiplier
<i>Are <u>resources sufficient and flexible</u> enough to support the mission?</i>	Primary reserve ratio <i>(Expendable net assets/ total expenses)</i>	×	50%
<i>Do <u>operating results</u> indicate the institution is living within available resources?</i>	Net income ratio <i>(Operating surplus or deficit/ unrestricted operating income)</i>	×	20%
<i>Is <u>debt</u> managed strategically to advance the mission?</i>	Viability ratio <i>(Expendable net assets/ Long-term debt)</i>	×	30%

Total composite score

Highest score possible is **5.00**

A score of **below 1.75** for **two consecutive years** results in an institution being placed on **fiscal watch**

How financially sustainable is my institution today?

The Composite Financial Index, or CFI, combines four financial metrics to provide a snapshot of an institution's current financial health

Financial ratios

Are resources sufficient and flexible enough to support the mission?



Primary reserve ratio
*(expendable net assets/
total expenses)*

Ratio threshold value = 0.4

Do operating results indicate the institution is living within available resources?



Net income ratio
*(operating surplus or deficit/
unrestricted operating income)*

Threshold value = 4%

Does financial asset performance sustainably support the mission?

Return on net assets ratio
*(change in net assets/
total net assets)*

Threshold value = 6%

Is debt managed strategically to advance the mission?



Viability ratio
*(expendable net assets/
long-term debt)*

Ratio threshold value = 1.25

CFI

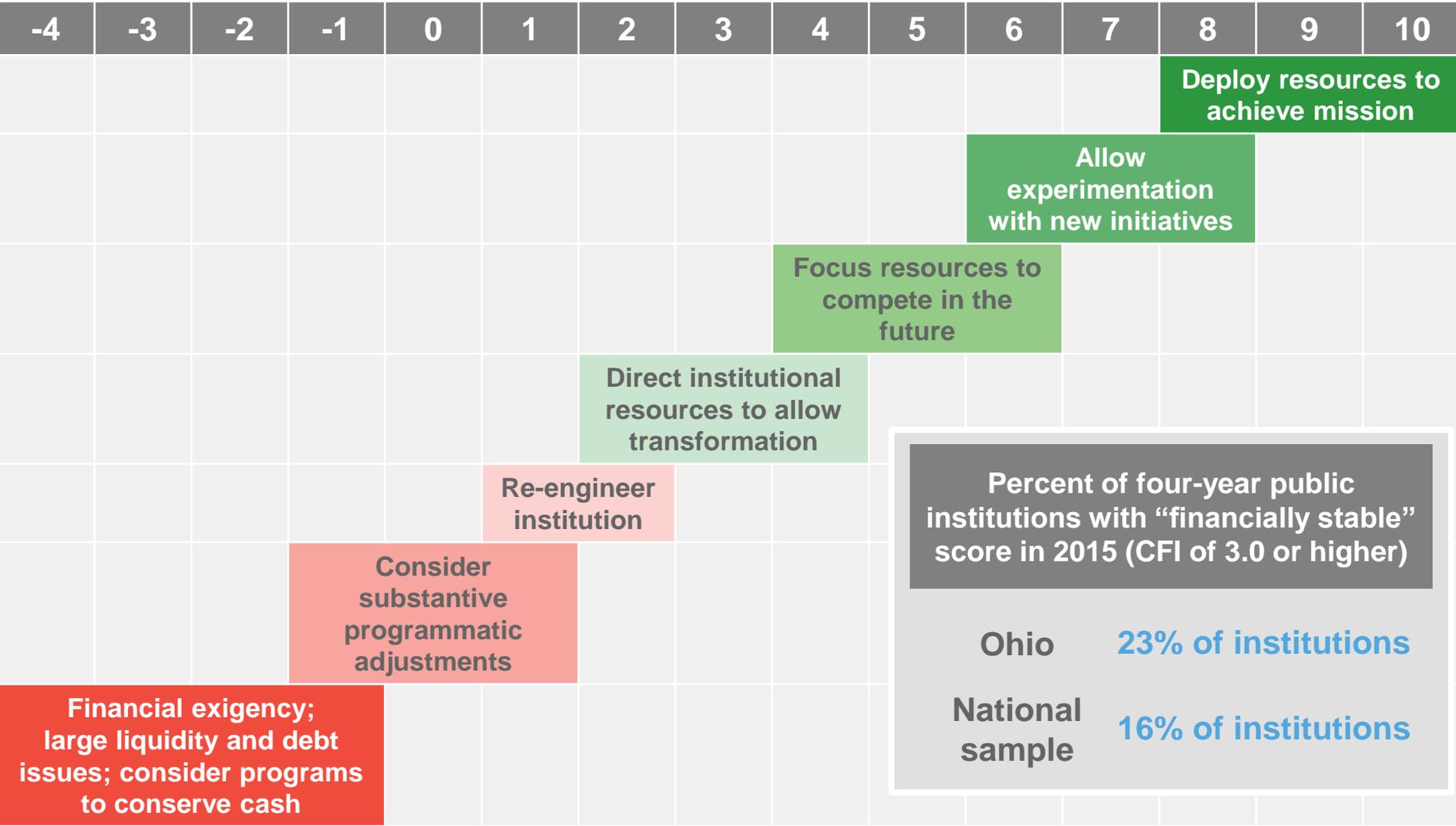
A single indicator of financial health that can be used to compare the overall financial health of an institution over time



Also a component of the Ohio Senate Bill 6 determination of financial health

How financially sustainable is my institution today?

A score of 3.0 or higher on the CFI indicates financial health



How financially sustainable is my institution today?

Three main sources of information can be used to gain more transparent information about institutional financial health to answer three key questions

External assessment of financial health – CFI or Senate Bill 6

- ▶ This is a comparable, standard assessment of financial health that distills a composite of multiple financial ratios for higher education institutions into a single score.

Institutional financial accounting and reports

- ▶ Standard audited financial reports are reviewed and approved by the board.
- ▶ May not provide sufficient information on financial health on their own.

Institutional managerial accounting and projections

- ▶ Operational reporting provides information about the drivers of revenue and expense.
- ▶ Hitting the right level of operational detail is sometimes challenging for boards.

1 How stable are my institution's current and future sources of revenue?

2 Are my institution's current and future expenditures aligned to revenues? Is the institution living within its means?

3 How is my institution balancing its budget and managing cash?

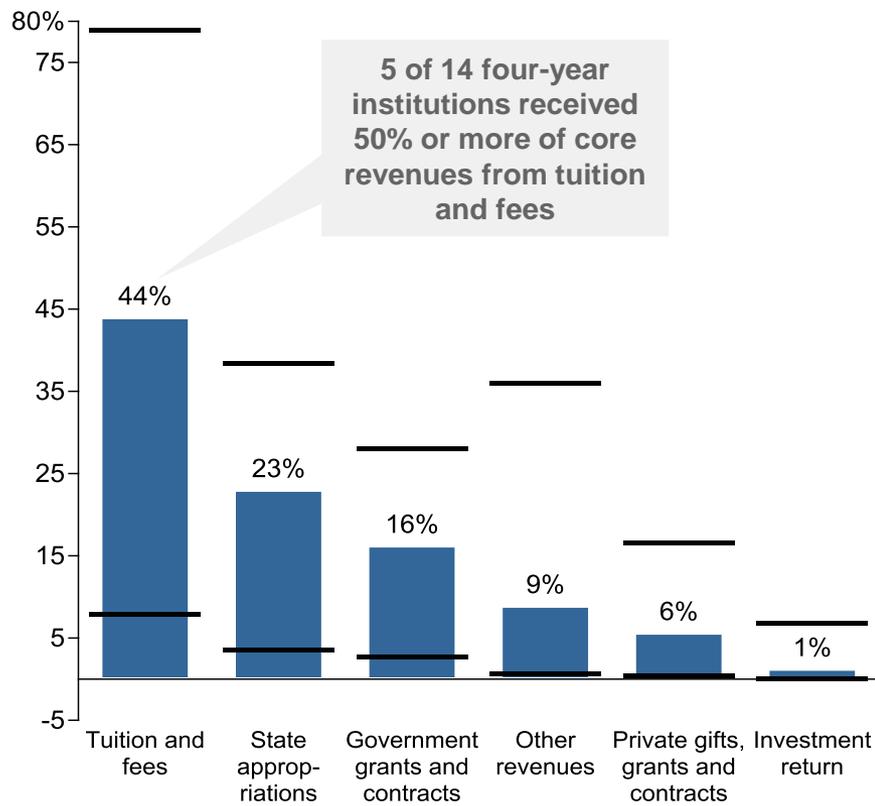
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How stable is my institution's revenue?

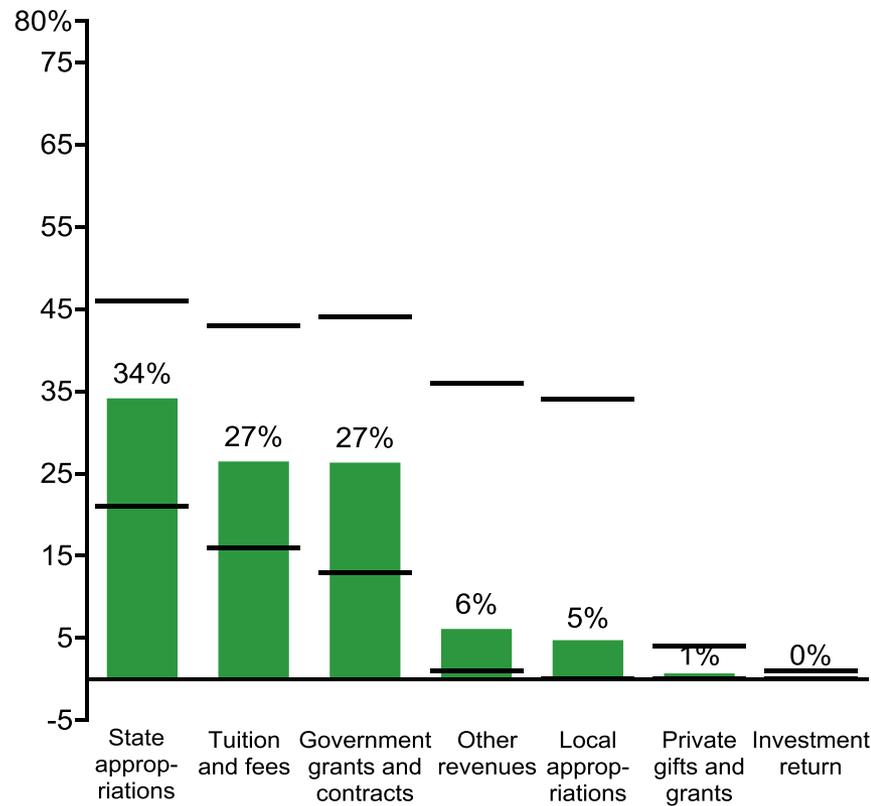
Institutions in Ohio receive funding from a variety of sources, with a wide range in how much each funding type represents in terms of core revenues

Average core revenues by source, as percent of total:
four-year institutions in Ohio, 2015



Min	8%	4%	3%	1%	0%	0%
Max	79%	38%	28%	36%	17%	7%

Average core revenues by source, as percent of total:
two-year institutions in Ohio, 2015



Min	21%	16%	13%	1%	0%	0%	0%
Max	46%	43%	44%	36%	34%	4%	1%

How stable is my institution's revenue?

At the highest level, what are potential areas of focus for board members?

Mix

- ▶ What are current sources of income?
- ▶ Is the mix healthy or is the institution overly reliant on a single revenue source?

Historic trends and underlying drivers

- ▶ What have the trends been for each revenue source?
- ▶ How has the mix shifted over time?
- ▶ What are the underlying drivers of each revenue source?

Projections

- ▶ What is the three- to five-year forecast?
- ▶ Is revenue expected to grow enough to cover cost inflation/growth?

Forecasting accuracy

- ▶ How reliable have our projections been in the past?
- ▶ What assumptions have we made in projecting each revenue source?
- ▶ Do we still believe these assumptions, given external context?
- ▶ What can be done to improve forecasting accuracy?

Drill deeper into drivers of core revenue sources

Tuition

State appropriations

Grants

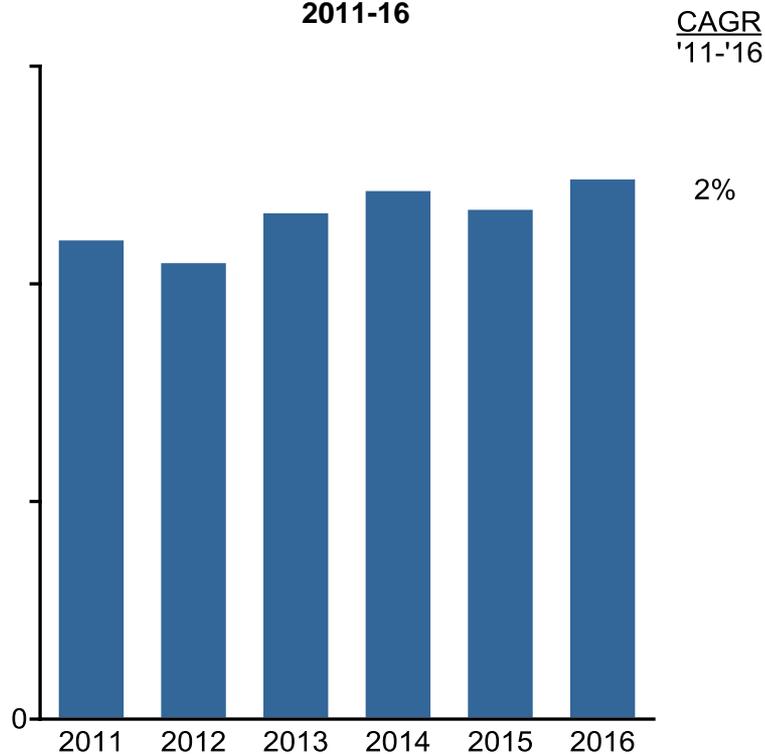
How stable is my institution's revenue?

Tuition revenue case study: stable long-term revenue trend may conceal important student mix shift

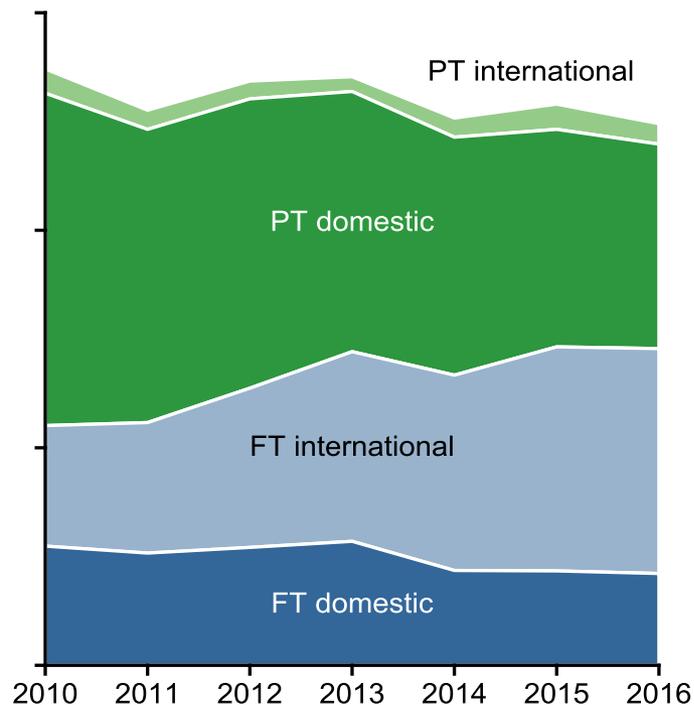
Master's programs seemed to be doing fine, with net tuition revenue growing 2% per year ...

... but that growth was masking the erosion of the part-time market and a large student mix change, with international students jumping from 50% to 70% of the full-time population

Net tuition revenue, all master's programs, 2011-16



Enrollment by full-time/part-time status, 2010-16



How stable is my institution's revenue?

Tuition revenue: looking at top-line metrics may not be sufficient; boards could ask questions to understand the shifts in underlying drivers of tuition revenue

Mix of students

New vs. returning	In-state vs. out-of-state
Full-time vs. part-time	"Traditional" vs. adult
Demographics	Incoming student quality

Mix of program enrollment

Degree level	Program area	Onsite/hybrid/ online
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Financial aid strategy

Percent of students receiving institutional aid	Percent Pell eligible
Award size over time	Overall tuition "discount"

Questions to ask

- ▶ What are the major changes over the past five years in student enrollment mix?
- ▶ How do our overall enrollment trends compare to the rest of the higher education sector?
- ▶ How do enrollment trends align with the institution's vision of who they serve?
- ▶ Are we appropriately investing in areas that are growing/in demand?
- ▶ Are we meeting students at their point of need (education delivery format)?
- ▶ Do we have seamless pathways into our institution (e.g., for transfers)?
- ▶ Are there opportunities to strengthen relationships with local employers to drive enrollment growth?
- ▶ How much is the institution spending year over year on financial aid? How effective is the financial aid strategy in achieving desired student mix?

How stable is my institution's revenue?

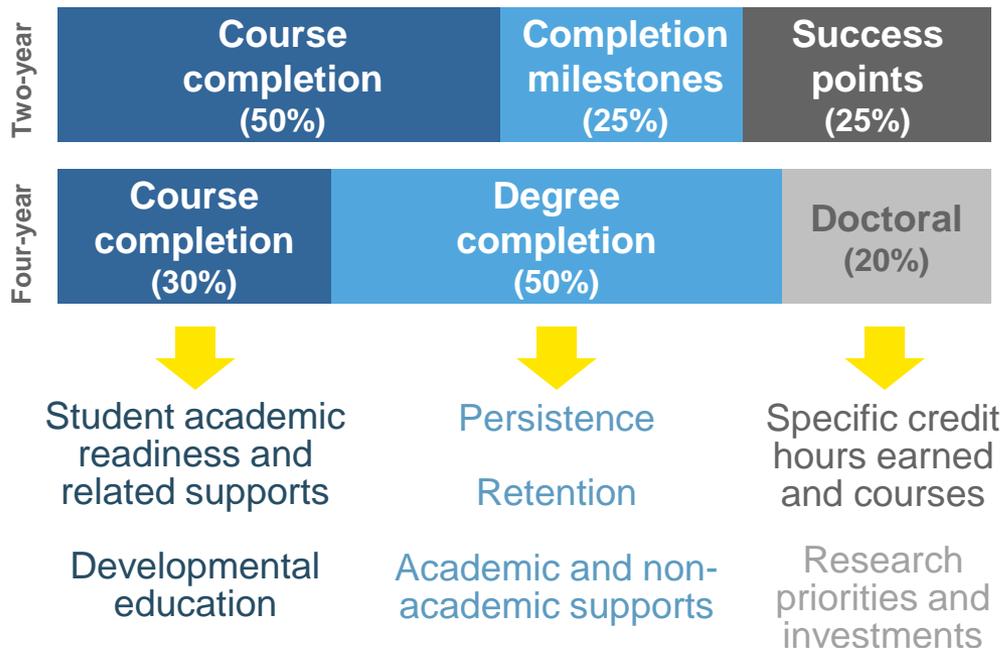
State appropriations: what grants and research-related questions could boards be asking in the Ohio context?

State appropriations

State appropriations as percent of total institutional revenue (two-year and four-year institutions; national sample)

Min	Average	Max
4%-21%	23%-34%	38%-46%

Core drivers of state appropriations



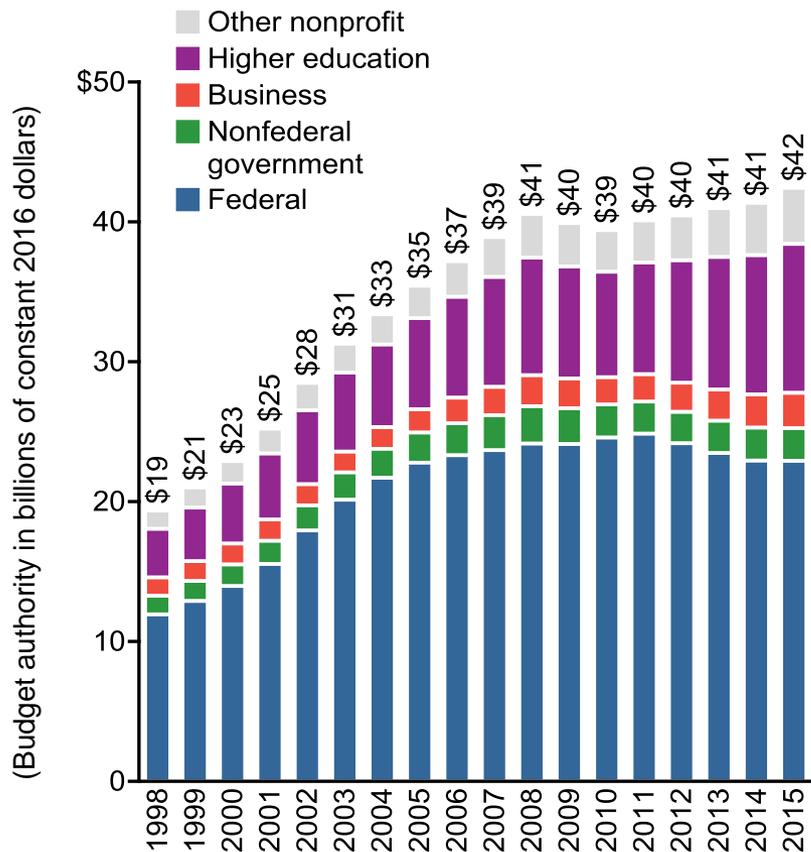
Questions to ask

- ▶ How dependent is my institution on state appropriations?
- ▶ How is my institution performing on the fundamental metrics that affect the state amount allocated to my institution (course completion, persistence, retention and ultimately graduation rates)?
- ▶ Are any subgroups of students within my institution differentially affected?
- ▶ How diverse is my student population? Are the supports aligned to the types of students my institution is recruiting?
- ▶ What is the cost of supports provided to students?
- ▶ In a constrained resource environment, where might it make sense to invest to improve outcomes? Where might the “return on investment” be highest?

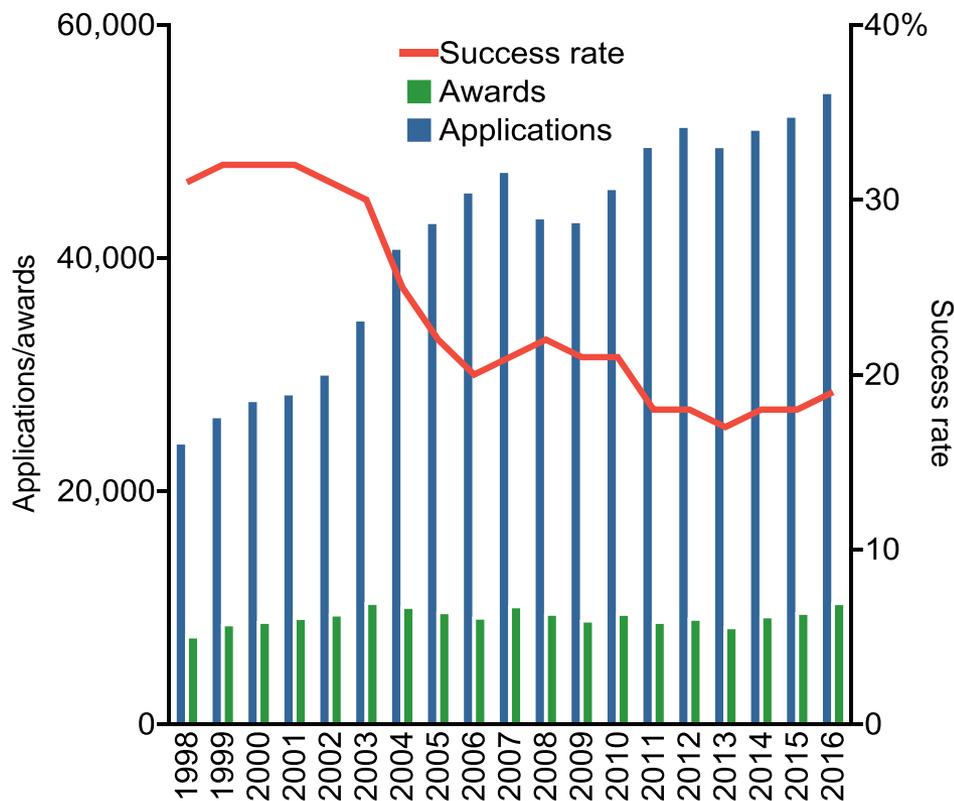
How stable is my institution's revenue?

Grants: research grant funding is flat nationally and increasingly competitive by historical standards

Research expenditures for US IHEs, by funding source (excluding Recovery Act funds) (1998-2015)



NIH application, award and success rate trends (1998-2016)

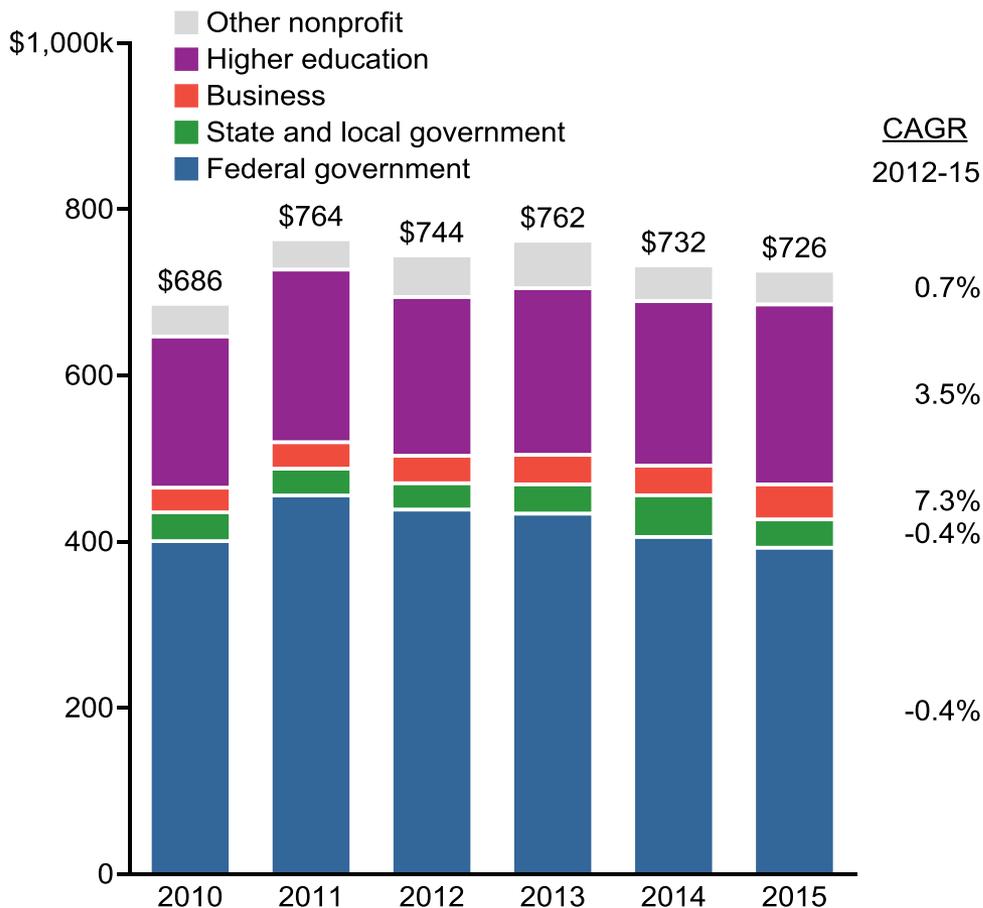


Sources: National Science Foundation, National Center for Science and Engineering Statistics, National Patterns of R&D Resources (annual series). Some data for 2014 are preliminary and may later be revised. The data for 2015 are estimates and will later be revised.

How stable is my institution's revenue?

Grants: what grants and research-related questions should boards be asking in the Ohio context?

Research spending in Ohio, by source at four-year public universities (2010–15)



Questions to ask

- ▶ How has my institution fared relative to the overall market (national or regional) in terms of accessing external funding?
- ▶ Research can be costly. Are we able to articulate all direct and hidden costs of research?
- ▶ What research costs would we be left with if grant funding decreased and how would we fund these costs?
- ▶ In what areas of research are we most competitive? Can we double down and invest more in these areas?
- ▶ Do we need to pull back in other areas?
- ▶ Is there an opportunity to establish closer collaborations with industry, locally/regionally/nationally?
- ▶ Is there an opportunity to establish closer collaborations with other universities and build critical mass in research that way?

Note: Other includes NCSES categories Nonprofit, Business, and All Other
 Note: Ohio State and Ohio University are excluded due to lack of consistent data availability (data unavailable from 2010-2013)
 Source: NCSES

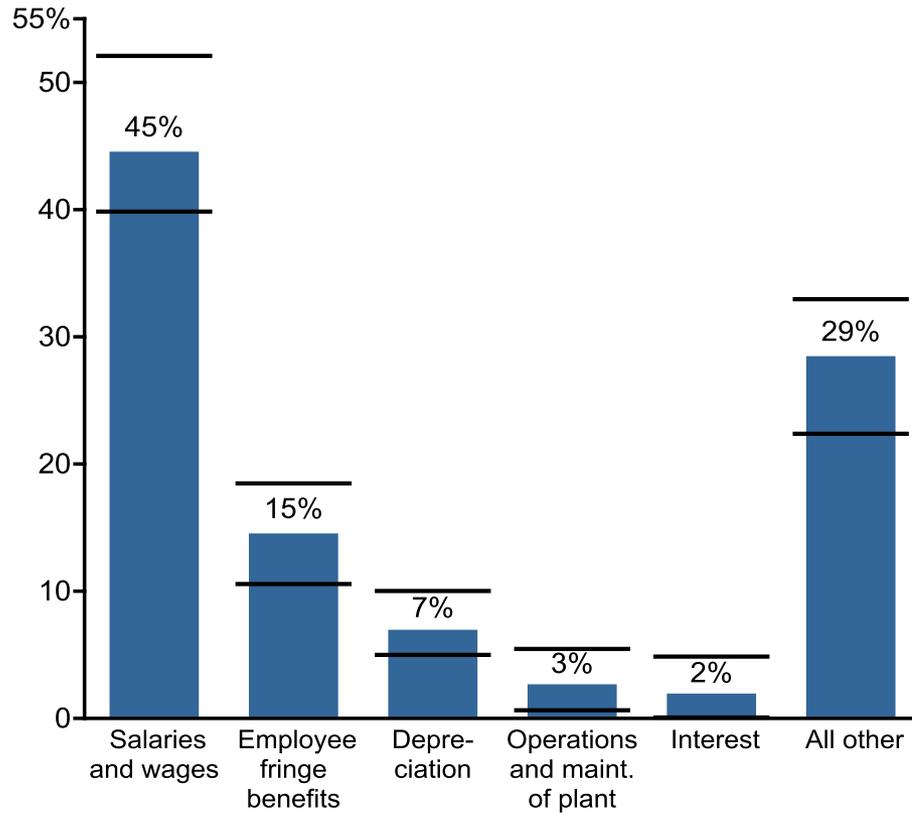
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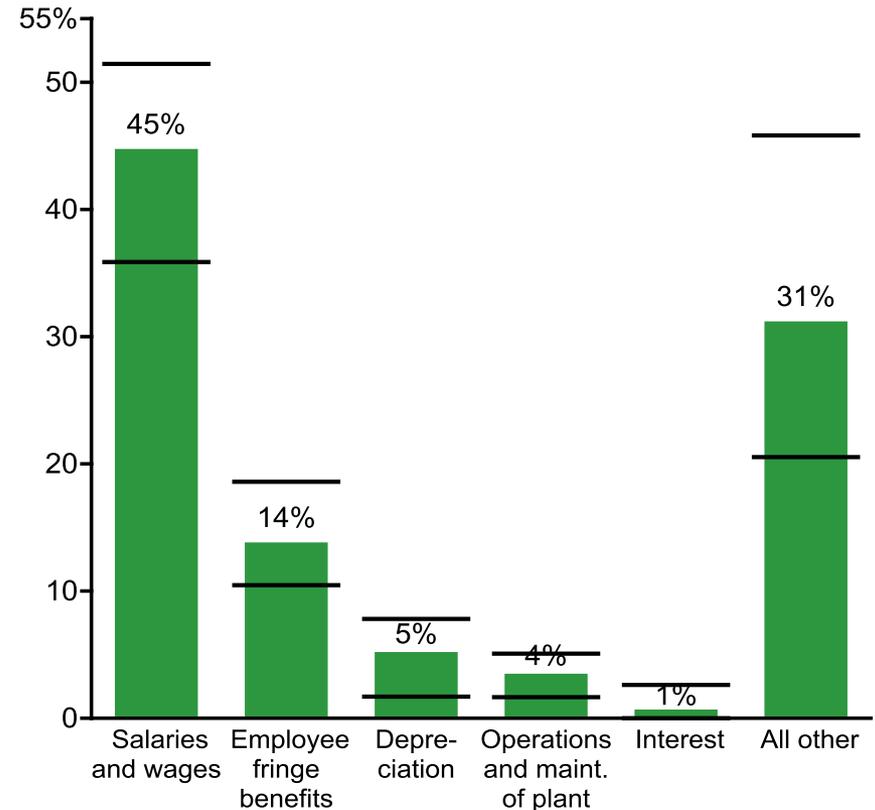
Are my institution's expenditures aligned to revenues?

Cost structures are more similar across institutions, with personnel-related costs accounting for ~ 60% of total core expenses on average

Average core expenses by category, as percent of total:
four-year institutions in Ohio, 2015



Average core expenses by category, as percent of total:
two-year institutions in Ohio, 2015



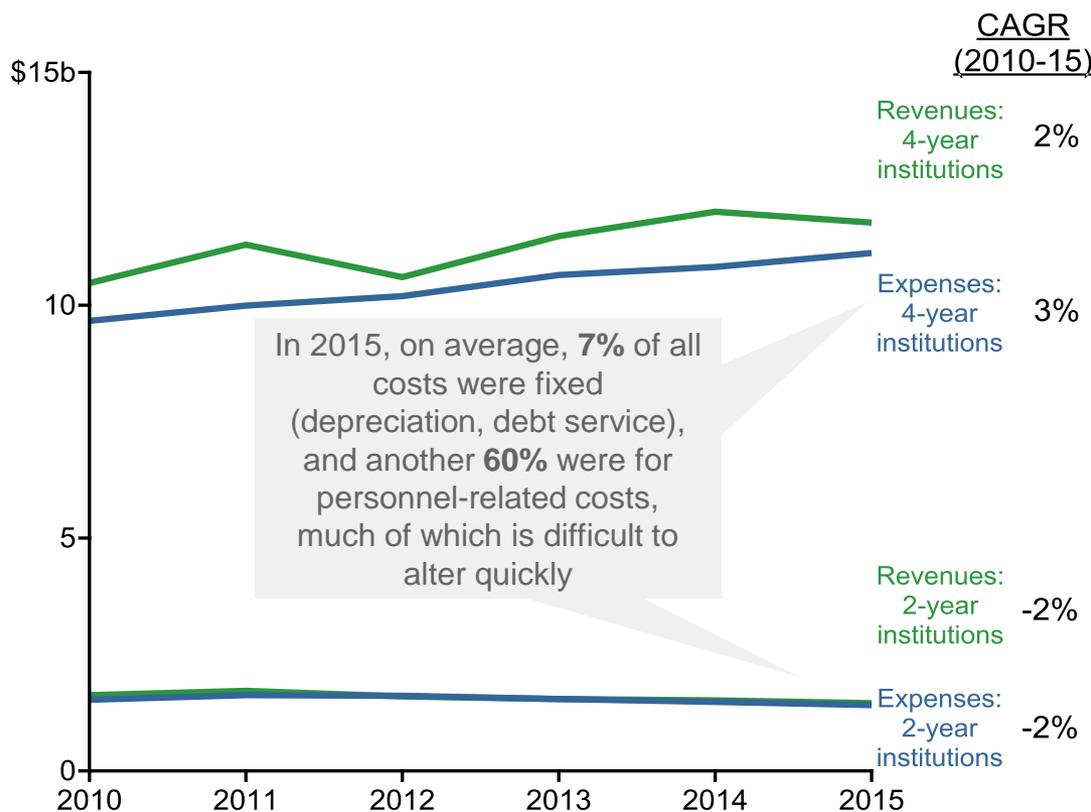
Max	52%	18%	10%	5%	5%	33%
Min	40%	11%	5%	1%	0%	22%

Max	51%	19%	8%	5%	3%	46%
Min	36%	10%	2%	2%	0%	21%

Are my institution's expenditures aligned to revenues?

Boards should seek to understand the degree to which expenses are in line with or outpacing revenue growth, taking factors like enrollment changes into account

Revenues and expenses over time across all Ohio public institutions (2010–15)



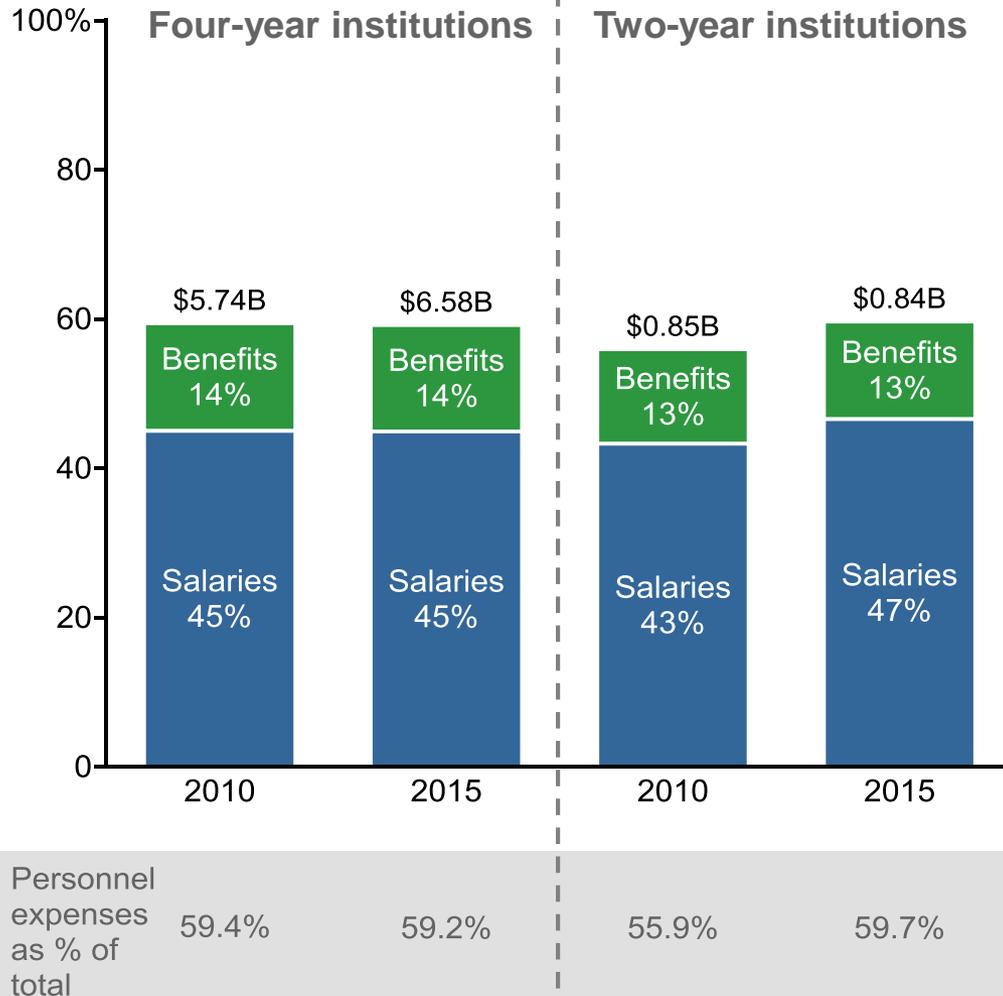
Questions to ask

- ▶ How have overall expenses trended relative to overall revenues in the last five years at my institution?
 - ▶ Are they in line with or outpacing revenue growth?
 - ▶ Are they tracking with enrollment trends?
- ▶ What are the largest expense categories and how have those trended over time at my institution?
- ▶ If expense growth is outpacing revenue growth, is there an opportunity to “right-size” some expenses?
 - ▶ One-time reductions vs. reductions that result in annual savings?
 - ▶ Has the institution already exhausted one-time savings opportunities?

Are my institution's expenditures aligned to revenues?

Personnel expenses: boards could seek to understand the personnel needs and distributions at an institutional and departmental level

Personnel-related expenses at Ohio public institutions (2010-15)



Questions to ask

- ▶ **How has salary and benefit expenditure changed over times?**
 - ▶ For example, staff or faculty full-time equivalent (FTE) per student?
 - ▶ Are there large variances across the institution, by school or department?
- ▶ **What are expected future personnel trends?**
 - ▶ For example, anticipated retirements or changes in enrollment trends and implications for recruiting and hiring
- ▶ **Are there opportunities to realign how functions are structured?**
 - ▶ To either improve quality of services delivered at same level of expenditures or reduce overall expenditures without sacrificing service levels?

Are my institution's expenditures aligned to revenues?

Debt service: boards could seek to understand what drives the level of debt (and debt service) and provide guidance on level of risk institution is willing to bear

Debt service nationally and at Ohio public institutions (2010-15)

Nation

- ▶ **\$240 billion:** collective college and university debt today ⁽¹⁾
- ▶ **18%:** increase in debt at public universities over last five years compared to **3%** increase in debt at private universities
- ▶ **\$41 billion:** record amount of borrowing through municipal bonds in 2016 vs. \$28.7 billion a decade ago ⁽²⁾
- ▶ **\$48 billion:** annual cost of servicing accumulated debt, which amounted to 9% of college and university budgets ⁽³⁾

Ohio

Long-term debt at Ohio public institutions ⁽⁴⁾

2012: \$5.7 billion	2015: \$6.8 billion		18% increase
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Questions to ask

- ▶ What is my institution's **capital plan**?
- ▶ Has the institution appropriately budgeted not just for **new construction**, but also for **renovations and upkeep** of overall plant?
- ▶ How is the institution planning on covering these expenses?
- ▶ Has the institution **deferred maintenance** for a number of years and what kind of future **liability** does this create?
- ▶ What impact will financing decisions have on **long-term debt levels** and **annual debt service levels**?
- ▶ What are **current and projected debt service levels** as percentage of total expenses?
- ▶ What is the **current debt structure** and is there an opportunity to restructure debt?

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How is my institution balancing its budget?

There are several ways in which institutions can balance budgets, but not all balanced budgets are created equal ...

	Method	Questions to ask
Highly preferred	A structurally balanced budget: annual revenues cover annual expenses	<ul style="list-style-type: none"> ▶ How sustainable is this? [previous section covered analysis of trends in revenues and expenses] ▶ What changes in cash balances have been seen over time? Are you “burning cash”? What are your cash reserves?
Less sustainable methods: act as a red flag	Institution transfers money across funds	<ul style="list-style-type: none"> ▶ Is the general fund subsidizing auxiliary or other funds at the institution? ▶ Is there transparency into which activities (funds) are self-sustaining? ▶ Which funds are subsidized and by how much? [e.g., athletics is often a subsidized activity]
	Institution dips into its reserve fund	<ul style="list-style-type: none"> ▶ Does the institution have a reserve fund? ▶ How much is in the fund? [e.g., relative to operating expenses] ▶ Under what circumstances can the fund be used? ▶ How often/consistently does this “dipping” happen?
	Institution borrows in the debt markets	<ul style="list-style-type: none"> ▶ What is the institution borrowing for? ▶ How will additional debt affect the institution’s overall credit rating? ▶ Are there one-time revenue-generating/cost-cutting opportunities that could help avoid additional borrowing?

Discussion and Q&A

- ▶ Do the data and questions we shared with you resonate? Are there any questions from this session that you would take back to your own institution?
- ▶ Do you feel you have access to the kind of data that would enable you to ask these types of questions?
- ▶ What potential challenges do you encounter in being able to have informed discussions about the financial health of your institution?
- ▶ ***Questions for us?***

Presenters



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Kasia is a leader in the firm's Education practice, with a focus on the US market. In 2003, Kasia moved to Harvard University, where over the course of six years she held several senior administrative roles, including Chief of Staff to the President and Provost.

Since rejoining Parthenon-EY in 2009, Kasia has focused exclusively on education sector engagements. Her work in the sector spans primary, secondary, and higher education systems, and includes higher education institutions (both public and private), school districts, state education agencies, and private foundations.

Kasia's higher education engagements have included strategic planning, governance and organization structure design, revenue generating strategies (online strategies, program development, alternative revenues), academic outcome improvement strategies, and operational efficiency improvement strategies.

Kasia holds a B.A. in Economics from Harvard University and earned her M.B.A from Harvard Business School.



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Samantha is a Vice President in Parthenon-EY's Education practice, with a focus on the US market. She has nearly 15 years of experience in management and strategy consulting on projects located across 20+ countries, predominantly focusing in the education industry.

Samantha has worked across the spectrum of education, from non-profit to for-profit, private to public, small to large, and at all ranges of selectivity. She helps leaders of these organizations advance their mission outcomes with the help of improved strategies and operations.

Her areas of focus include strategic planning, market entry and growth, operating model design and transformation, digital and analytics strategy, performance management and stakeholder management.

Samantha has an M.B.A. from INSEAD and a B.A. in Economics and International Business from Brandeis University.

About Parthenon-EY and the Education practice

About Parthenon-EY

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About Parthenon-EY's Education practice

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