

Overhauling Your Financial Reserves for Higher Education

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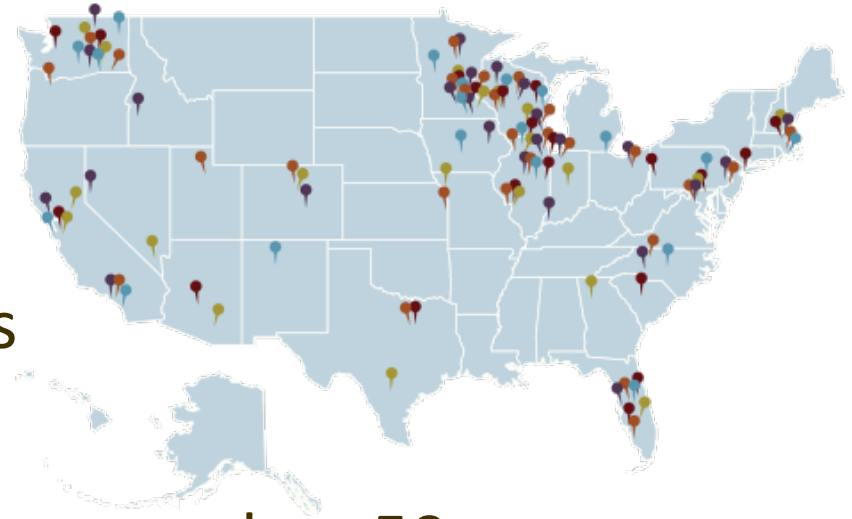
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- A professional services firm with three distinct business lines
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Speaker Introductions

Ben Aase



- Principal
- Aided in starting the earliest charter school outsourced accounting and financial advisory service firms
- Leads projects with K – 12, foundation, nonprofit, and quasi-governmental clients nationwide

Matt Ceppi



- Principal
- 19 years as higher education administrator and consultant
- Worked with university leadership on integration, alignment and fostering of strategic and long-range planning, enrollment planning, and resource allocation planning

Learning Objectives

- At the end of this session, you will be able to:
 - Explain the importance of financial reserves to your business model.
 - Apply an interactive process to establish and adjust reserve targets that will engage your organization's staff.
 - Outline a data-driven reserves policy that will build trust with your organization's stakeholders.
 - Recognize how your reserves policy can integrate with your financial planning and reporting.



Why Colleges and Universities Need Reserves

- To bridge cash flow needs
- To maintain financial solvency
- To weather economic cycles
- To fund expected opportunities
- To fund unexpected opportunities
- To protect yourselves against unpredictable political behavior
- To purchase and maintain productive assets
- To drive capacity for new debt to fund major capital needs



What We're Seeing and Hearing

Then, on the same day in 2013 in which the UW System president proposed a 2 percent tuition increase, we learned that the System had more than \$648 million in cash reserves at the end of the previous fiscal year. It was insulting to students and parents forking over thousands per year to the System. *Portage Daily Register

Campus Use of Financial Reserves Questioned

*The Daily Californian

Ohio's universities have almost \$3 billion in cash, document shows
Big reserves become factor in state budget debate *The Columbus Dispatch

Is UC Reserve Fund Debacle More Complex Than It Appears?

*California Magazine/ Just In

Moody's: Colleges Can Expect Another Year of Low Growth in Tuition Revenue

*The Chronical of Higher Education

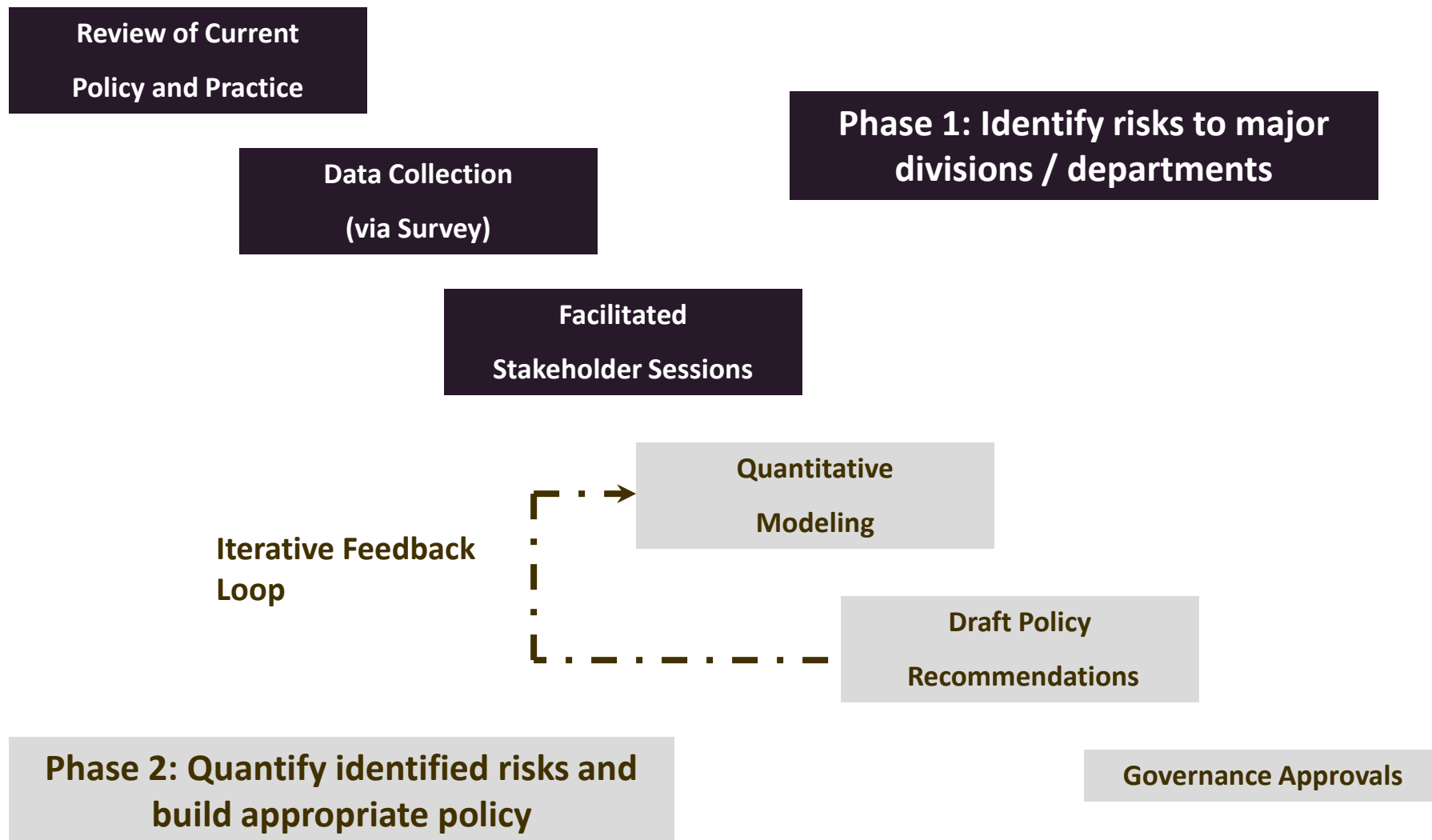


End Game = Sustainability

The ability to carry out activities that will achieve your mission while also developing and maintaining capacity for mission relevance in the future.



1 Approach / 2 Phases / 6 Steps



Review of Current Policy and Practice

- Current reserve policy and historical context
- Business and financial reporting structure
- Historical reserve targets vs. actual performance and use
- Credit rating reports
- Related risk (e.g. SWOT) or strategic planning documents for each program, department, or entity-wide
- Capital improvement plans
- Investment allocation risk analytics



Data Collection (via Survey)

Suggest surveying internal departmental directors

- Direct service delivery at the departmental or site level
- Business and finance
- Information technology
- Physical plant

Questions revolved around...

- Identifying specific business risks
- The likelihood and timing of their occurrence
- Their anticipated financial impact
- Their categorical nature
- Alternative mitigation strategies



Sample Survey Questions

It is important that  as a whole, maintain reserves for the following reasons:

- ☐ To adjust for bad years
- ☐ To support initiatives and opportunities
- ☐ To react to changes in the business model
- ☐ To survive large scale change
- ☐ To respond of emergencies
- ☐ To provide stability
- ☐ To pay for litigation
- ☐ It's just good practice
- ☐ Other (please specify):

- True or False: xxx current reserves policy works well?
- What are the most critical cost drivers in your department?
- Keeping both your cost drivers and income sources in mind, what potential high impact risks could result in your department's need to access reserve dollars?



Sample Survey Questions (cont.)

The likelihood of this risk affecting us is:

- ☐ Low (25% or less)
- ☐ Medium
- ☐ High (75% or higher)

If this risk is going to affect us, it will do so within the following time frame:

- ☐ Up to 12 months
- ☐ 1 - 3 years
- ☐ 3 - 5 years
- ☐ 5 - 10 years
- ☐ > 10 years

If this risk were to affect us, it would result in what financial harm to the organizational unit? *(Please be specific but concise in providing an aggregate dollar impact and the duration of impact projected.)*

How much of this impact *(in dollars or percent)* will you be able to mitigate without access to reserves?

Taking into account the responses above, this risk best fits into which of the following categories?

- ☐ Operating: *to fund ongoing operational expenses during economic disruption (< 12 months)*
- ☐ Capital Improvement: *to fund major information technology and facility needs*
- ☐ Business Model: *to fund operations over a 3-year period during a significant change in the [redacted] or OU model*
- ☐ Legal: *to fund costs associated with litigation*
- ☐ Market Volatility: *to fund unanticipated investment losses caused by market volatility*
- ☐ Initiative: *to fund business initiatives requiring significant developmental or start-up costs*



(Optional) Facilitated Stakeholder Sessions

Goals:

- Test department response to seeing the survey data in aggregate
- Fill any data gaps or clarify items that required interpretation
- Move to consensus, most likely scenario for each identified risk
- Test the materiality of smaller risks identified
- Explore rationale in assigning likelihood, timing, and financial impact
- Test risks identified by other respondents to ensure they are:
 - Appropriately excluded
 - Void of any overlaps and disputes

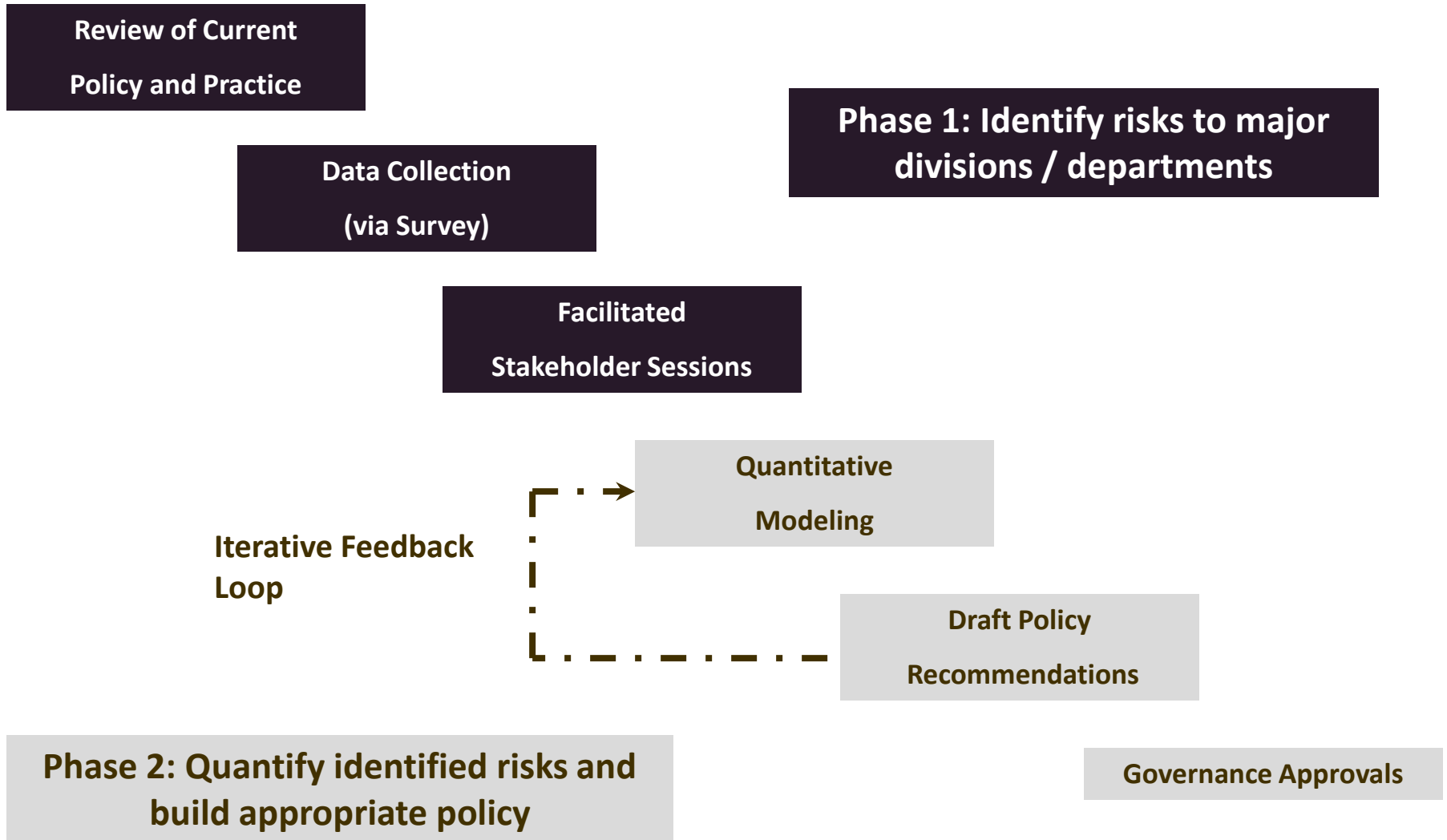


Sample Session Agenda

- Introduction and Perspectives of Participants
- Review Committee Charge
- Ground Rules
 - Risks vs. Opportunities
 - Insurable vs. Uninsurable Risks
 - Budgeted New Initiatives vs. Reserve Contingencies
- Review of Survey
 - Agree on nature, likelihood, impact timing, and dollar exposure
 - Review proposed financial model conventions
 - Consider overlap with other operating units or departments
 - Identify additional reserve requirements
 - Agree on adjustments to survey results
- Open Discussion and Wrap-Up



On to Phase 2



Quantitative Modeling

Objective: To develop a data-driven financial reserve model that quantifies the risks identified in surveys and stakeholder sessions against current reserve levels, and that provides institution with a reasonably comprehensive yet practical tool to carry forward.

IEEE Organizational Units - Risk Assessment

Name:

Select your organizational unit (OU):

Region	1	2	3	4	5	6	7	8	9	10
(Division, Section and Technical Committee)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

It is important that IEEE **resources** maintain reserves for the following reasons:

- ☐ To adjust for lost years
- ☐ To support initiatives and opportunities
- ☐ To react to changes in the business model
- ☐ To survive large scale change
- ☐ To respond to emergencies
- ☐ To provide stability
- ☐ To pay for litigation
- ☐ It's just good practice
- ☐ Other (please specify):

My estimate for the above is that IEEE **resources** should be sufficient at any given time to cover the following broad contingencies affecting IEEE as a whole:

-- a

-- b

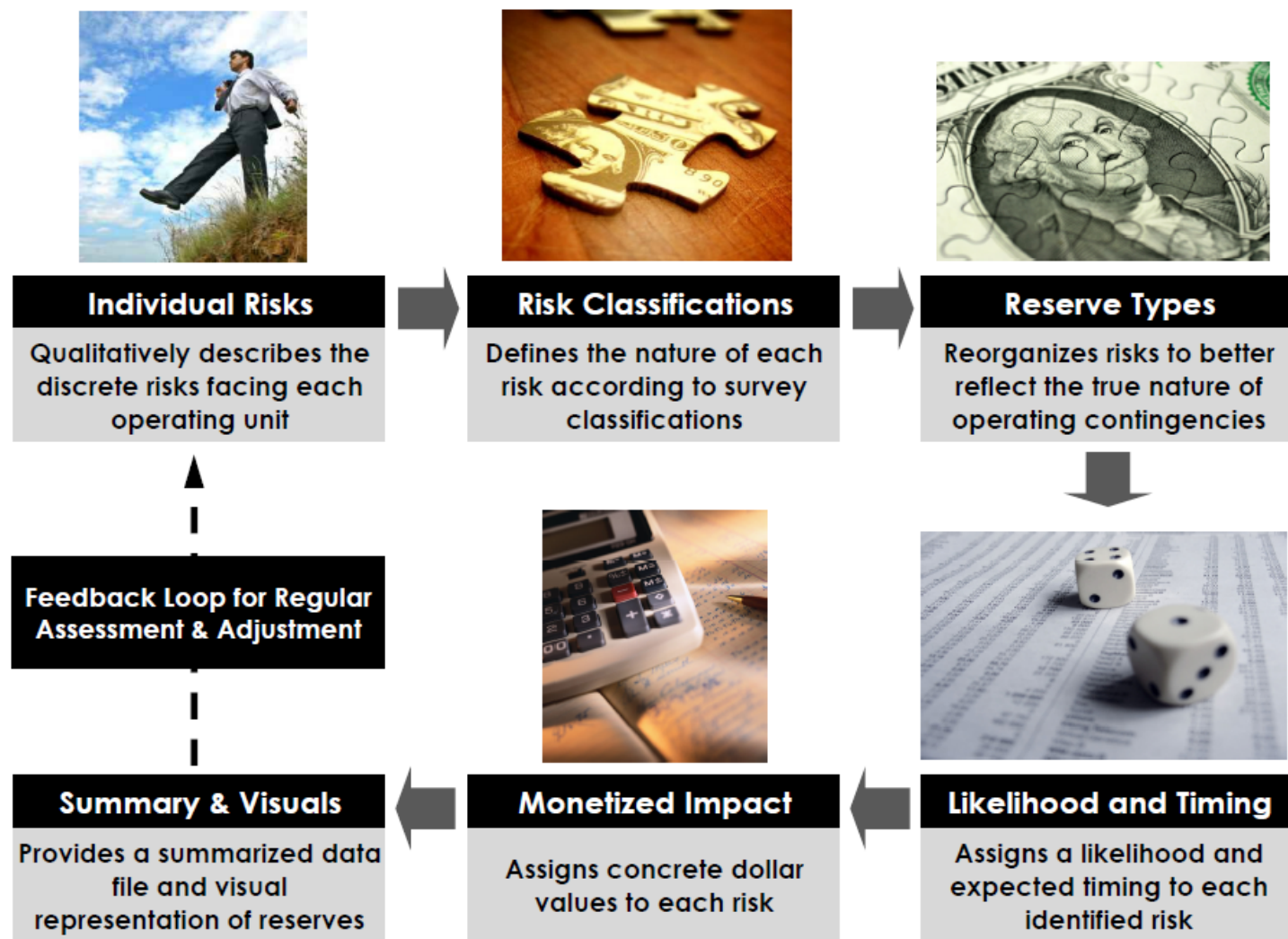
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*CLA-IEEE

Result: A compilation of total financial risk that can be analyzed by various characteristics – reserve type, time horizon, likelihood, etc.

Reserve Model Schematic



Recommended Reserve Categories

Enrollment

A reduction in enrollment due to environmental, competitive, and functional factors.

Net Tuition Variance

A reduction or shift in tuition due to economic downturn, political change, or statute.

Fundraising Activities

Poor performance on fundraising or grant-seeking activities.

Debt Compliance and Capacity

To meet covenants on existing debt and fuel capacity for new debt to fund major capital needs.



Recommended Reserve Categories (cont.)

Capital Investment

Repair, replacement, or expansion of major physical and technological infrastructure.

Employment Funds

Uninsurable litigation risks.

Major Initiatives

Entity-wide strategic undertakings not yet executed.

Other Unplanned Contingencies

Unclassified ongoing business risks.



Data Summary

Projected requirement of \$10 million at full risk valuation.

Recommended reserve categories are as follows.

Capital Investment	\$	2,300,000	23%
Major Initiatives		2,300,000	23%
Net Tuition Variance		1,700,000	17%
Enrollment		1,000,000	10%
Fundraising Activities		400,000	4%
Debt Compliance and Capacity		400,000	4%
Employments Funds		400,000	4%
Other Unplanned Contingencies		1,500,000	15%
Total	\$	10,000,000	100%



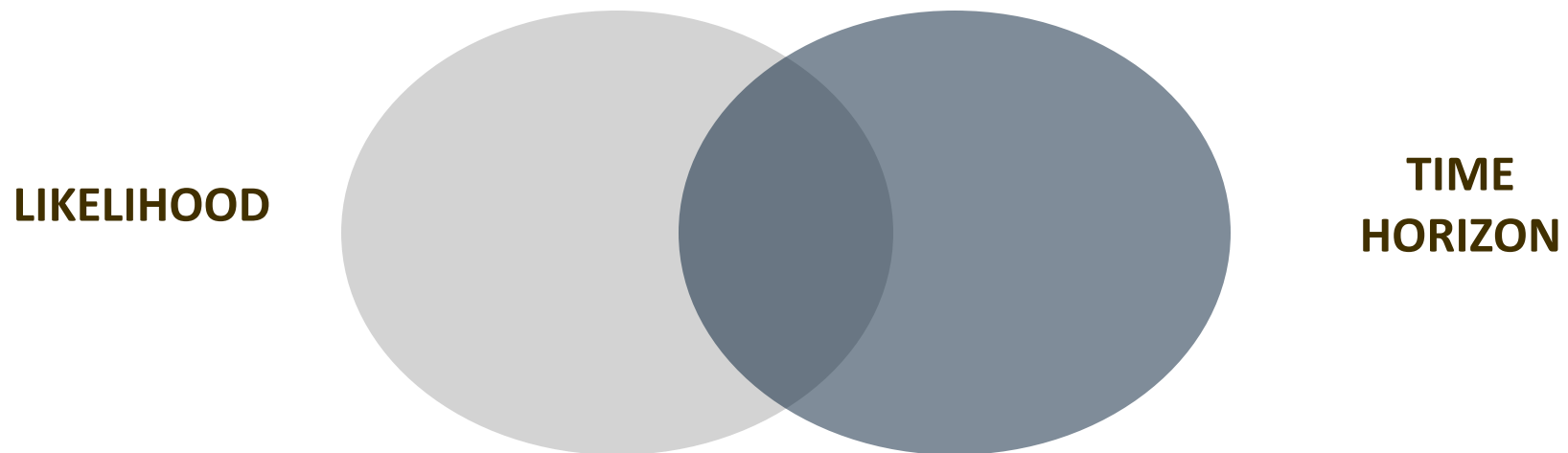
Not Everything Will Happen At Once

A reserve level of approximately \$7.1M would capture all risks assigned either a medium or high likelihood and a time horizon of 5 years or less.

...accounts for 71% of all identified risks at full their valuation.

...represents 52% of forecasted fiscal year 2014 operating expenses.

...offers a subjectively reasonable bottom range.



Recommendation

Based on current risks and forecasted fiscal year operating expenses of \$13.7 million, the institution should maintain reserve levels between \$7.1 million and \$10 million.

	Reserve Level	% of Forecasted FY Expenses	% of Current Risks at Full Value	Amount Over / (Under) Current Reserve Level
Ceiling	\$10 Million	73%	100%	\$1 Million Over
Current	\$9 Million	66%	90%	—
Baseline	\$7.1 Million	52%	71%	\$1.9 Million Under



Other Considerations

- The nature of these risks will continue changing
- Our recommendation is not a static range
- Institutions will need to update the data model for significant budget growth or reduction and changing risk profile based on activities
- Possible methodologies for further refinement
 - Subjective Scenario Modeling: Interactive, more variability
 - Regression Analysis
 - ◇ Expected Value: Simplistic, would likely undervalue reserve needs
 - ◇ Normal (Gaussian) Distribution
 - 1 Standard Deviation = 68% of fully valued risks
 - 2 Standard Deviations = 95% of fully valued risks



Governance Approvals

- Proposal: Change our Reserves Policy
- From the present...
 - The minimum recommended goal is to have reserves at least equal to one half of the total budgeted yearly expenditures.
- To a policy based on a data-driven approach...
 - Total Reserves Risks / Exposure



Proposal

- The Total Reserves Risks (TRR) shall be the sum of all reasonable potential draws on our reserves.
 - We will use a bottom-up method to determine TRR.
- FinCom will annually determine TRR update process.
 - FinCom will conduct reviews at least once every three years.
- The lower and upper reserve targets shall be determined by FinCom as follows:
 - Lower: \$7.1 million (Today = 71% of current TRR)
 - Upper: \$10 million (Today = 100% of current TRR)



Proposal (cont.)

- FinCom will annually set target points as dollar amounts.
 - FinCom will review and recommend annually or upon major changes for approval. Treasurer can call for a review as needed.
- The state of the actual reserves will be tracked and reported in FinCom's monthly financial reporting package.
 - Actual reserves are defined as the reserves market value minus forecasted reserves spending plus forecasted operations surplus
- If reserves fall below the lower reserves target...
 - Treasurer will notify President and hold a FinCom discussion within two weeks.
 - FinCom will recommend any suggested actions.



Risk is...well, risky...what to watch out for

- Segregate current risks from hypothetical ones.
 - Conversely, changes in strategic direction warrant reassessment.
- Know which risks should be mitigated through insurance and/or litigation rather than reserves.
 - Separate reasonable, ongoing risks to your school from singular catastrophic events that could jeopardize entity-wide solvency.
 - Beware of duplicative risks.
 - Address the nuances of precedent relationships between risks when analyzing for aggregate financial impact.



Questions?

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