Managing the Financial Enterprise of the Institution

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- Critical processes
- Effective budgets
- The annual audit
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A view from the top

- The present challenges to higher education in general, and Christian higher education in particular, are well known
- What is often lost amidst the urgency of the present environment, however, is the need to consider normal business risks
- Managing the institution's financial enterprise involves a wholistic and comprehensive approach that incorporates not only the normal financial matters but also addresses the resiliency plan of the institution
- I invite you to engage in this discussion from the perspective of a CEO seeking to mitigate risk and uncertainty where that is possible

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A view from the top

- Maintaining the financial integrity of your institution is critical to your mission
  - Few things, other than sexual impropriety, will get you to the top of the scandal sheet quicker
- The task begins with you
- Though you will delegate accordingly, there are things that remain your responsibility. You may require accountably from others, but the ship remains yours. Whatever happens will be on your watch.
- You will be evaluated on the tone you set. It makes a difference.

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A view from the top

- Having the right people in specific roles is critical to your success. At a minimum they are:
  - A well trained and motivated CFO
    - They must have your full support
  - Competent personnel to oversee the regulatory and compliance areas of financial aid and the management of programmatic grants
  - Access to a respected and approachable legal counsel
    - Experience with faith-based institutions is helpful
    - The ability to advise on employment practices is also desirable
  - A relationship with your audit partner or manager will pay dividends and greatly aid your oversight responsibilities

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Critical processes

- An effective institutional budgeting process that is integrated with the overall efforts of institutional planning
- An effective enterprise risk assessment
  - Comprehensive in nature and involves a wide range of institutional input
  - Classifies risks as financial, operational, security/fraud, compliance, or reputational
  - Assesses both probability of occurrence and potential impact of risks
  - Informs the efficient use of resources designed to mitigate risk
  - Underpins the comprehensive plan for institutional resilience
    - I.e., the successor to disaster recovery planning

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Critical processes

- Cybersecurity awareness and planning
  - Because of its potential impact, it deserves special mention
  - Not a question of IF but WHEN
  - Absolute protection from breaches is not realistically possible
  - Focus must be on detection, containment, and recovery
  - Likely requires outside expertise
    - Have a team well-formed and ready
  - Is a never-ending process. There is no such thing as being done.
  - Ignore at your peril!!!

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An effective budget

- Should both inform and reflect the institutional planning process
- Must be as reliable as possible but not unduly precise
- Should demonstrate how financial resources are used to provide adequate support to the educational process
  - Remember, accreditation standards expect programs of study to be adequately supported by financial resources
- Should be clearly defined. E.g., What is a balanced budget?
- Should adequately delineate between operating vs. capital expenditures
- Should account for cash vs. non-cash expenses and thus present an understandable projection of actual cash flows

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An effective budget

- Specific metrics should be clearly presented
  - Operating revenues with the following clearly delineated
    - Net tuition revenue
    - Donations
    - Grants
  - Operating expenses
  - Income from operations (i.e., Total OPREV minus Total OPEX)
    - Always know this value and the direction in which it is trending
  - Other items of non-operating income and expense
  - Change in unrestricted net assets (the "bottom line")

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An effective budget

- A best practice is to also provide a projected budget of cash flows delineating between net cash flows from:
  - Operations
  - Investing
  - Financing
- It is not as hard to prepare as some may think
- The investing section can be expanded to provide a list of expected capital expenditures for which budgetary authority is either desired or requested

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An effective budget

- The best practice is to match the budget format to the format of the statement of activities that will appear in your annual financial statements
- Those statements will be your official scorecard for the vast majority, if not all, of the stakeholders of interest
- If you simply refuse to do this, you absolutely must prepare a reconciliation of your budget to your projected change in net assets. A failure to do so essentially impairs the connection between your plans and the way your ultimate outcomes will be assessed.
- Of course, there should always be a meaningful review of budgeted versus actual results

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An effective budget, critical metrics

- The ratios required by the USDE or its counterparts are important and must be followed because of the impacts they may have
- However, with respect to both budgets and actual results, the following are critical metrics that measure the overall health and resiliency of your financial position
  - Income from operations, both the amount and the trend
  - Change in net assets
  - The current ratio (current assets divided by current liabilities)
    - A minimum value of 1:1 is critical
    - Anything below this signals a potential problem with your liquidity

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An effective budget, critical metrics

- Institutional reserves
  - What is the amount of unrestricted cash and investments on hand?
    - How many months of annualized operating expenses will your institutional reserves cover? Six months is a good target.
  - This is a straightforward assessment of your financial resiliency. The six-month target reflects the nature of your typical academic periods.
- Long-term debt
  - What are your LTD maturities over the next five years. This will be disclosed in your financial statements and is potentially impactful on your future cash flows. Be alert to large maturities and their potential effect on your banking relationships.

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The annual audit, pain or potential value?

- An effective annual audit requires a great deal of commitment from both institutional and audit personnel
- While that effort may not always be enjoyable, it does not have to be painful
- Understanding what an audit is and what it is not is essential to the process
- A lack of respect for the audit, or a dismissive attitude as to its findings, signals there may be underlying areas of potentially serious concern.
  - You never want to be perceived in this light, or appear uninformed as to the fundamental nature and purpose of the audit

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Audit: the good, the bad, & the ugly

- An ugly audit:
  - The auditor seems to think everyone is either ignorant or out to hide something. The entire process is painful and requires what appears to be an inordinate amount of work to satisfy the auditors. Results take forever and you get blamed for it.
- A bad audit:
  - The auditor does their job and the opinion is okay, but that is it. The experience may or may not have been eventful for the staff. There is little contact between audit personnel and institutional leadership.
- A good audit:
  - While the effort required of personnel may be substantial, the reasons are always clear and seldom seem contrived or unnecessary. There is clear and useful information about the audit findings. The institution's financial performance and position are discussed along with industry trends and implications for the future of the institution.

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An audit, what it is not

- It is not a guarantee of your financial position, future performance, or lack thereof
- It is not a guarantee that no fraud was present at your institution.
  - However, the auditor will advise you if any fraud was encountered
- It is not the cause of your financial position or of your operating results
  - No university president should ever be heard to say, "Everything was fine until our auditors……."
  - Regrettably, it does happen

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An audit, what it is

- It is a professional opinion about whether or not your annual financial statements "present fairly in all material respects the financial position of your institution, the changes in net assets, and cash flows as of, and for the year ended ….in accord with accounting principles generally accepted in the [resident country].
- It is your final and official scorecard for the year presented. You may have other reports that are internally used in government or management, but your annual financial statements, and the report of the independent auditors thereon, is the information source most valued by a majority of your interested stakeholders.
- It is the most comprehensive source of financial information about your institution available in one place. The data contained therein may be relied upon for a host of important analytical procedures.

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Audit Value Adds

- You should expect your audit partner or audit manager to review the principal findings of their examination with you and/or your CFO and staff.
- This review should cover the opinion and any material findings in the review of internal control.
  - Don't be overly concerned with significant deficiencies that are common within your environment. Instead, merely take them seriously and look for solutions to the issue.
  - Conversely, do take material weaknesses with the seriousness they deserve. If you do not, you are without excuse if something negative happens as a result thereof.
- The auditor should also conduct an in-depth review of your key financial ratios and how you compare with your peers. Pay special attention to this analysis and any substantive differences between your institution and others in your "weight class"

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Audit issues of significance

- Anytime an auditor modifies their opinion, the report will be very specific as to how and why the modification occurred. Pay attention and make sure you fully understand the reasons why and the implications they entail.
- Expressions about whether or not the institution is viable as a "going concern" are increasing in frequency. They are not a death nell but they should never be discounted or ignored. Conversely, you should seek to be sure your remedial actions are clearly and substantively presented in the relevant notes to your financial statements and that you and your auditor are both comfortable with those plans.
- Emphasis of matter paragraphs are also increasingly common within our environment. They are are less startling than the going concern warning and are designed to alert stakeholders of trends that, left untended, may escalate to more serious issues. Accordingly, take them seriously and respond accordingly.

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Audit: The representation letter

- Professional auditing standards require that the auditor obtain a representation letter from senior institutional leadership. This will necessarily include the CFO and CEO.
- This is a comprehensive document in which you will be expected to assert or "represent" that certain things are as they seem. Among the more substantive, for example, you will state whether or not you are aware of any known or suspected fraud. You should read this letter carefully before you sign it and discuss with your auditor any items with which you are the least bit uncomfortable.
- One of the most important things you will affirm is that the financial statements under examination are the responsibility of the institution and that you and your staff are responsible for the content thereof.

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Audit: The representation letter continued

- Please understand that while the auditor may, in fact, seem to draft the financial statements, they are prepared from information provided entirely by your accounting staff.
- The auditors drafting of the statements themselves is tantamount to solving a jigsaw puzzle. They may put the pieces in their proper places (i.e., the required disclosure format) but you created the puzzle, and it belongs solely to you.
- Once you sign this letter, there is no room for blaming the auditor for any of your financial problems or claiming something contrary to what you have represented in the letter.
- Remember, read before you sign

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Parting thoughts

- Among the important professional relationships you maintain, two are especially relevant in the present environment of Christian higher education.
- Principal donors
  - Take care to develop personal connections these people. Keep them informed about the financial position of the institution and of your best view of its future. Emphasize your commitment to financial integrity and transparency in reporting your institutional results.
- Bankers
  - Make sure to have a close relationship with your lead creditor banks. Know their position and direction on lending to institutions like yours. Ask them frankly how they view your organization and what is their outlook on lending to you. Do not be surprised by any actions they take.
- With respect to principal donors and your bankers, both HATE surprises. Never let them be dismayed by reading your annual financial statements.

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Q & A

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Thank you

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