EFFECTIVE FINANCIAL MANAGEMENT IN HIGHER EDUCATION

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THE ESSENTIAL ROLES AND RESPONSIBILITIES OF THE CFO

Session 1

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ESSENTIAL ROLES

- Preserve, protect, & defend your organization's financial integrity & reputation
  - Assure revenues are used as intended
  - Assure funds are expended as authorized
  - Assure that the manner in which financial affairs are conducted is above reproach
- Generate financial information that is useful for both
  - Historical assessment (financial reporting)
  - Informed decision making
    - Keep in mind that for information to be useful it must be BOTH timely and reasonably accurate (we will define "reasonably")

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ESSENTIAL ROLES

- Unless assigned elsewhere you will likely have, or share, major responsibility for:
  - Risk assessment & management
  - Human resources
  - Information technology & security
  - Physical plant
  - Legal services
- We will have more to say about each of these

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ESSENTIAL ROLES

- Perhaps the most important point I wish to make today is the following observation:
- CFOs are often immersed in the narrow, albeit essential, role of financial accounting and reporting. A CFO, should additionally seek to broadly inform the decision-making processes of the organization in a manner that adds value to it.
- Because of your comprehensive understanding of your institution's finances, this is your sweet spot. It is what transforms you from a sideline reporter to a play-caller. Embrace it!!!

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ESSENTIAL ROLES – THE FIDUCIARY DUTY

- All members of the leadership team have a fiduciary duty to the organization
- The CFO's duty is heightened because you are the guardian of the institution's financial integrity
- Your duty is to the organization AND its stakeholders, not just the President
- If you are a CPA, CA, or lawyer, you have professional conduct obligations that may transcend all else

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ESSENTIAL ROLES – THE FIDUCIARY DUTY

- Your fiduciary duty is defined in the following ways
  - You have a duty to act in the best interest of others (the organization and its stakeholders)
  - Legal responsibility; you must comply with the law. Jail is a bad place. Do not go there.
  - Ethical responsibility; if the law is silent or uncomprehensive, what is the most appropriate thing to do given all the understandable variables?
  - Moral responsibility; transcends even the ethical. This speaks of right and wrong as defined by our spiritual ethos. But, beware, never let this get out of hand and take a stand on something based upon a moral position that is, in fact, not entirely black and white.

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ESSENTIAL ROLES – ACCOUNTING INTEGRITY

- A reliable system of internal control is the foundation upon which all else must be based. It includes both of the following
  - Accounting controls
  - Organizational and operational controls
- Internal control is almost always challenging for ABHE institutions
  - Most likely due to smaller staff and difficulties with segregation of duties
  - Requires the cooperation and engagement of the CEO and governing board to be effective
    - If they are not onboard, abandon ship!
  - Solutions are often novel and easier than you might expect

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INTERNAL CONTROLS, A CLOSER LOOK

- Accounting basics
  - The person who receives the mail and deposits checks should not have responsibility for recording the revenue or reconciling the bank statement
    - Alternatives involve bank lockboxes, accounting firms, or third-party payment processors
    - Online payments are great options and also provide web access
    - Credit card fees, while significant are still cheaper than people
  - The person who signs checks must, preferably, not be the one who originates the check and must NEVER reconcile the bank statement
    - Use a third party if necessary for reconciliation. E.g., accounting firm
  - There must always be some form of check on the CFO if anyone detects exceptional behavior
    - Consider third-party review of journal entries

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INTERNAL CONTROLS, A CLOSER LOOK

- Remember that your audit firm can do no actual accounting work for you nor be the third-party internal control resource. Doing so impairs their independence thus precluding them from performing the audit
- The audit firm can, however, assist you in designing the system of internal controls
- Enlisting their help in this matter is good because they will be the ones reviewing the controls as a part of performing their audit and commenting on the effectiveness of those controls

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INTERNAL CONTROLS, A CLOSER LOOK

- Organizational controls are also imperative.
  - A classic example is the policy by which your institution determines whether or not it will accept a gift with donor restrictions and, if it does, how it will segregate the funds
- Compliance with the Uniform Prudent Management of Institutional Funds Act, or its equivalent, is essential
- At a minimum all institutions should have clear board policies on how funds are segregated and how the institution prevents restricted funds from being used for purposes, including general expenses, in violation of their restrictions.
- Raiding restricted funds for non-restricted purposes = something bad is about to happen

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INTERNAL CONTROLS, A CLOSER LOOK

- Controls over human resource actions are often overlooked as part of a system of internal accounting control
- This must not be the case
- Personnel actions from hire to end-of-employment must be clearly documented and properly approved
- There should always be a clear (legally informed) checklist of things that should occur before either the hiring or involuntary termination of an employee
- Complex systems are not required. A simple narrative of the employment cycle and delineation of where approval is required and granted goes a long way.

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INTERNAL CONTROLS, A CLOSER LOOK

- Control over physical plant matters is also imperative especially in regard to policies outlining authorized use of assets
  - A side note: Always have a policy specifically authorizing de minimus use of assets for personal purposes (e.g., occasional use of the copier, etc.). This avoids problems with your auditor and his or her responsibility to report instances of fraud without regard to materiality. Without such a policy, the line between authorized and unauthorized use of assets (i.e., fraud) can become murky
- Physical property management is also an area ripe for formal checklists with scheduled reviews thereof

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INTERNAL CONTROLS, A CLOSER LOOK

- We will discuss cybersecurity in more detail later, but certain IT processes must be carefully monitored within the internal control framework
- Guarding databases, and access to them, is just as significant today as was locking up ledgers in a fire-proof vault 50 years ago
- Controlling access, virtual and physical, to all forms of electronically stored data is imperative to maintaining its reliability

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INTERNAL CONTROLS, A FINAL THOUGHT

- At the end of the day, an effective system of well-documented internal controls along with clear evidence of adherence thereto protects you, your colleagues, and your institution from allegations of impropriety.
- The absence thereof, does exactly the opposite.

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RISK MANAGEMENT

- In recent years, a shift occurred in risk management philosophy. More precisely, the concept of disaster preparedness/recovery has given way to the concept of resilience planning.
- This shift is predicated on the realization that you cannot plan for every possible scenario. However, you can plan for the way you will respond to any scenario.
- Resiliency theory calls forth the notion that responding to any crisis always involves 3 things:
  - People
  - Places
  - Things

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RISK MANAGEMENT

- Modern resilience plans answer the fundamental questions:
  - Who is in charge and who will do what?
  - Where will they do it?
  - With what will they do it?
- This approach does not negate the need for checklists defining a response to a given crisis. It merely assures that there is a structure in place for responding to a crisis whether there is a predefined checklist or not.

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RISK MANAGEMENT

- A key foundational component of an effective resilience plan is an Enterprise Risk Assessment (ERA)
- This assessment provides a comprehensive view of all identifiable risks with materially problematic outcomes
- The assessment will consider both the probability of occurrence and the potential impact
- Risks are classified as follows:
  - Financial risk
  - Operational risk
  - Security/Fraud
  - Compliance
  - Reputational

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RISK MANAGEMENT

- A key benefit of an ERP is that it informs the allocation of scare resources to where they are most needed
- Because an ERP requires assessments of potential impacts you avoid spending $1,000 to prevent the potential loss of $100
- To be effective, ERPs must be based upon the widespread input of the entire institutional leadership. They should never be one-person operations

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RISK MANAGEMENT, AN EXAMPLE

- Other than a global pandemic, list the top 5 institutional risks with greater than a nominal possibility of occurrence and a potential material adverse consequence:
  - Loss of a major donor
  - Inability to renew maturing debt
  - Decline in enrollment
  - Cybersecurity incident
  - Loss of doctoral faculty
- Assess the probability of each, compile them in weighted average form, address responses accordingly

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Risk Assessment Example
Risks identified and ranked 1 - 5; 5 = highest risk

Identified risk	Financial	Operational	Security/Fraud	Compliance	Reputational	Raw Score	Weighted Score	Relative Rank
Loss of a major donor	4	2	3	3	1	13	2.70	3
Inability to renew maturing LTD	5	4	4	5	4	22	4.45	5
Decline in enrollment of a given percent	2	1	2	2	2	9	1.80	2
Cybersecurity incident	3	5	5	4	5	22	4.25	4
Loss of key doctoral faculty	1	3	1	1	3	9	1.80	1
Weighting factor; Sum = 100%	30%	20%	15%	15%	20%			

RISK MANAGEMENT – WEIGHTED RANKING

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RISK MANAGEMENT EXAMPLE

- Alternatively, or in connection therewith, you can also construct a probability assessment based on the following example to help quantify the weighted potential risk exposure
- This accomplishes two important things:
  - The potential risk exposure can then be an aid in assessing appropriate reserves or insurance coverage to mitigate the financial impacts of such risk
  - It gives guidance to what most likely requires the greatest amount of attention
- The next slide illustrates such an example

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RISK MANAGEMENT EXAMPLE

IDENTIFIABLE RISK	FINANCIAL IMPACT	PROBABILITY OF OCCURRENCE	PROBABILITY ADJ. IMPACT
Loss of major donor	$250,000	10%	$25,000
Inability to renew debt	$1,000,000	10%	$100,000
Decline in enrollment	$100,000	30%	$30,000
Cybersecurity incident	$250,000	25%	$62,500
Loss of doctoral faculty	$60,000	60%	$36,000
Total prob. adj. exposure			$253,500

This example only assesses financial impact

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CYBERSECURITY

- Understand the threat matrix – you are on it!!!
- Most likely vulnerabilities
  - Ransomware
  - Compromise of personally identifiable information
  - Will likely result from either phishing or spear phishing via email
- Solar Winds hack created a paradigm shift in the cybersecurity threat matrix
  - Supply chains now vulnerable
- Information security is now an elevated role
  - You likely cannot afford an in-house security role of necessary proportions – you must outsource and have your response team/plan in place before a breach

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CYBERSECURITY BASICS

- This is a continuous process, not an annual event!!!
- Breach is assumed; containment is the goal
- Supply Chain is in play
- Gold Standard includes a closed network and end point detection
- Start with local area network and your individual workstations
- Principle of least possible privilege
  - Avoid administrator privileges unless absolutely necessary
- Allow only whitelisted devices on network
- Endpoint detection is essential (E.g., Rapid7)

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CYBERSECURITY BASICS

- Always maintain updates to operating systems; force them
- Network wide virus protection if at all possible
- Use Barracuda Networks if you can afford it
- Identify critical databases; write and enforce backup policies; rely on checklists
- Maintain off-net copies if possible
- Daily (30) Monthly (12) Annual (=>7)
- Understand protections offered by 3rd party vendors
- Use KnowB4, or similar service, for awareness training and rigidly enforce; consider letting offenders go. It really is that serious.

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CYBERSECURITY BASICS

- Multi-factor authentication is absolutely critical when accessing cloud-based resources; its use in on-premise systems is also helpful especially in remote work environments
- If you are hit with a ransomware attack, seek professional assistance BEFORE attempting to load your backups
  - This is why your response team/plan must be in place
- Get to know your local FBI agents from the Counterintelligence Division and use their resources and guidance
  - They are really cool!

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LEGAL AWARENESS

- Along with risk management advisors and investment professionals, I strongly encourage at least annual meetings with attorneys to review the:
  - General legal affairs of the institution
  - Human resource/employment law developments

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BUILDING & MANAGING THE INSTITUTIONAL BUDGET

Session 2

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EFFECTIVE BUDGETING

- An effective budget must be:
  - Sufficiently complex as to incorporate all needed measurements
  - Simple enough to be used by all persons whose decisions will impact the actual results
- Always remember most users of the budget will not be financial types
  - Make the relevant content readable and available to them
  - Be sure your budget is detailed enough for decision makers of various units, but I strongly suggest a summary format for the president and board
    - You do not want the board arguing over the make and model of the maintenance truck
- Remember accreditation standards require that you demonstrate academic programs have sufficient funding to enable their success

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EFFECTIVE BUDGETING

- While the budget does not have to be in precisely the same format as the financial statements, I strongly suggest rolling things up for governance purposes in a way that mirrors the statement of activity
  - That is, after all, the scorecard against which budget performance will be compared.
- In any case an effective budget should:
  - Clearly delineate projected operating revenues including net tuition, donations, and grants
  - Projected operating expenses by major category
  - Projected income from operations
  - Other items of non-operating income and expense
  - Projected change in net assets

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EFFECTIVE BUDGETING

- In addition to rolling the budget up into a format compatible with the statement of activity, I also strongly recommend a pro forma presentation of projected cash flows from
  - Operations
  - Investing activities
  - Financing activities
- This does not have to be as detailed as that in the financial statements, but it helps
- The investing section may be expanded ,if necessary, to provide a list of capital expenditures
- This presupposes that you have adequately distinguished between capital and non-capital expenditures and between cash and non-cash expenses.

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EFFECTIVE BUDGETING

- Budgeting is not easy. If it were, Staples would do it. A key factor in minimizing the pain is assuring that you avoid unneeded complexity and undue precision.
- Remember, since you don't control everything in the world, it is not possible to perfectly project anything.
- There is such a thing as good enough. Always ask this question. How close do I have to be to affect a decision?
  - Never use uncertainty as an excuse to delay the budget!
- Keep in mind, amendments to the budget during the year are actually allowed and sometimes a really smart thing to do.

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EFFECTIVE BUDGETING

- Getting buy-in up front from those who will use the budget is critical to success.
- Keep in mind a common standard:
  - If a responsible person is expected to make a decision based upon a budget outcome, then there should be a budget component displaying those outcomes
- I like budget reports that show period-to-date results as well as comparison with previous years where such comparisons are meaningful

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EFFECTIVE BUDGETING

- As a general rule, every budget category should have its principal drivers identified (E.g., Number of semesters hours enrolled for tuition revenue)
- If you are good at spreadsheets, you should make these drivers easily changeable for purposes of sensitivity analysis
- Budgets do not have to be strictly financial in nature. It is also very helpful to report on driver metrics (E.g. number of semester hours enrolled). Doing this helps answer the questions of 1) Do we have a meaningful variance in budget vs. actual and if so, 2) why?

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EFFECTIVE BUDGETING – TRAPS TO AVOID

- Letting emotion do the math
  - Let the data speak
  - Don't rationalize away clear indicators
- Sacrificing timely reporting on budget performance
  - Reality Check: If the report is too late to affect decisions it becomes nothing more than historical analysis
- Invalid assumptions of correlation between budgetary forecasts and the underlying drivers (flies do not cause garbage)
- If you insist on using an alternate budget format, define what it is
  - E.g., What is a balanced budget?

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KEY PERFORMANCE INDICATORS & DASHBOARDS

Session 3

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EFFECTIVE FINANCIAL LEADERSHIP – SESSION 3 KPIS AND DASHBOARDS

- Key performance indicators vs. key financial indicators
  - They are not always one and the same
- KPIs are measurements of performance across the institutional spectrum. They are not confined to financial metrics alone.
- KPIs may, however, be financial in nature
- The "KEY" in KPI is identifying those indicators that are, in fact, key to planning and oversight
- Of course, it goes without saying, that many operational KPI's (E.g., retention rates) will ultimately manifest in financial terms

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KPIS AND DASHBOARDS

- Frankly, you will be more adept than I at identifying these KPIs. Some, however, would be obvious.
  - Enrollment data including retention and graduation
  - Gross tuition
  - Net tuition after scholarships and discounts (very important)
  - Uncollectible receivables if at all significant
  - Metrics from enterprise activities such as:
    - Bookstore
    - Cafeterias
    - Concessions
    - Athletic fees

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KPIS AND DASHBOARDS

- Are specific KPI's controllable or mere indicators?
- In selecting KPIs, always ask the question, How is this indicator best used?
  - Does it tell us how we did (lagging) or does it predict what is going to happen (leading)
    - Or does it do both (E.g., enrollment retention trend)
- Know how a KPI can be misused.
  - E.g., looking at an increasing trend in gross tuition without examining net tuition for the same period

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KPIS AND DASHBOARDS

- Inevitably, the academic processes of assessing outcomes & institutional effectiveness generate a plethora of KPI's
- Contrarily, it is not always self-evident to non-financial types within Academia as to how these indicators ultimately manifest in financial impact
  - Be very careful in assuming that it is evident to all concerned
- Coordination between at least the chiefs of finance, academics, and institutional development is paramount in laying a foundation for an effective dashboard

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KPIS AND DASHBOARDS

- Harking back to our budget discussion, KPIs may be needed at the academic program level. In many respects, remember they are akin to business units
- Keep in mind, not all academic programs are created equal. Some may be profitable, others not so much. Know which is which.
- Profitability is not always necessary at this level (think loss leaders) but questions of sustainability must always be addressed

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KPIS AND DASHBOARDS

- Think of a dashboard as a common display of critical facts
- In their most effective form, dashboards will be informative across the leadership spectrum
- I posit that to be useful in this manner the following are critical descriptors:
  - Relatively simple; they present the most critical information clearly and concisely and in a way that alerts the user to a need for a deeper dive
    - Remember your speedometer tells you how fast you are going, not why.
  - How concise? Think about it like this:
    - Short enough that a user will want to know what is happening more than they will dread having to "read the whole thing"
  - Developed with buy-in from the full set of users

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KPIS AND DASHBOARDS

- Getting buy-in: How do we do it?
- Ideally, you should ask every user what they both need and want to know. Asking this question and giving users opportunity to have input is critical and often surprisingly motivational. Any good leader on the team really wants to know how their areas of operations are performing.
- Obtaining agreement about the definition of the KPI, how it is derived, and what, exactly, it means is imperative.
- Always keep in mind, that you know some things that must be measured that will not be in other's wheelhouses.
- Follow up with users and be sure they are understanding results correctly

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KPIS AND DASHBOARDS – AN EXERCISE

- Identify 5 metrics that are potential KIPs in each of the following categories:
  - Direct financial impact
  - Indirect financial impact
- Rank each item in each category 1 – 5 in order of importance
- The goal of this exercise is to demonstrate what will hopefully be the tendency of your mind to drift toward that which matters most

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UNDERSTANDING KEY FINANCIAL RATIOS

Session 4

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THE FINANCIAL RESPONSIBILITY SCORE

- Please forgive me but I do not really want to spend much time on this topic.
- You know how it works if it applies to you better than I do
- It is primarily a tool of government. I have over forty years of experience with governmental measurements. They never were the most important indicators except to the government.
- Frankly, as an accreditor, its use to me was primarily as an indicator that I needed to look more closely at the financial picture. That was about all.
- I had rather look at more comprehensive indicators that are useful to decision making

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A PROLOG BEFORE DIVING IN

- We always spend time evaluating our current financial position; that is our balance sheet
- Of comparable importance are the results from our operations AND cash flows
  - Ignoring cash flows is tantamount to discounting the importance of the blood in our veins!!!
- It is essential to understand financial performance from operating activities vs. the bottom line
  - This frequently requires looking a results a bit differently than the GAAP presentation
  - Current assets & liabilities no longer presented in favor of financial assets
- The process of reviewing results of operations and cash flows is the area wherein overlap with KPIs is most likely to happen

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KEY FINANCIAL RATIOS – AN EXAMPLE

- We will look at two institutions
  - Thoughtful Theological Seminary
    - and their archrival
  - Devout Divinity School
- Our analysis will draw quite heavily from the methodology used by those who extend credit to us (They tend to be quite dispassionate and objective)

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Balance sheet	Thoughtful Theological Sem.	Devout Divinity School
Cash & Investments	500,000	6,000,000
Other current assets	1,000,000	500,000
Total current assets	1,500,000	6,500,000
Property, plant & equipment	11,000,000	11,000,000
Total assets	12,500,000	17,500,000
Current liabilities	750,000	750,000
Long term debt	6,000,000	6,000,000
Total liabilities	6,750,000	6,750,000
Net assets		
Without restrictions	5,000,000	10,000,000
With restriction	750,000	750,000
Total	5,750,000	10,750,000
Total liabilities & net assets	12,500,000	17,500,000

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Statement of Operations	Thoughtful Theological Sem.	Devout Divinity School
Tuition	1,500,000	1,500,000
Contributions	500,000	1,000,000
Other program revenue	250,000	250,000
Total revenue	2,250,000	2,750,000
Operating expenses other than D& A	1,250,000	1,250,000
Depreciation & amortization	500,000	500,000
Total operating expenses	1,750,000	1,750,000
Operating income	500,000	1,000,000
Interest on LTD	300,000	300,000
Change in net assets	200,000	700,000

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Statement of Cash Flows	Thoughtful Theological Sem.	Devout Divinity School
Cash flows provided by (used in)		
Operations	700,000	1,200,000
Proceeds from LTD	-	1,000,000
Invested in PP&E	(500,000)	(500,000)
Payments on LTD	(250,000)	(250,000)
Net change in cash flows	(50,000)	1,450,000

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Ratios	Thoughtful Theological Sem.	Devout Divinity School
Current ratio (CA/CL)	2.00	8.67
Quick or Acid Test (Cash+Inv./CL)	0.67	8.00
Debt to Equity (TL/NA)	1.17	0.63
Times Interest Earned	2.50	1.43
(Change in N/A+Interest Exp)/Interest Exp.		
Debt Service Coverage	1.27	2.18
Operating Cash Flows/(Interest & Principle payments on Debt)		
Leverage Ratio (Total Debt/EBITDA)	6.00	4.00
Cash + Investments to Net Assets	8.70%	55.81%
Net Assets to Annual OPEX	3.29	6.14
Cash & Investment to Annual OPEX	28.57%	342.86%

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THANK YOU VERY MUCH FOR HAVING ME

NOW FOR
QUESTIONS & ANSWERS
(HOPEFULLY)

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