Mount Allison University: Report on Finances

March 16, 2013

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Executive Summary: We analyzed the published annual financial statements of Mount Allison University over the period 2006 – 2012 with a view to assessing the ability of Mount Allison to direct more resources to the academic side of operations, such increasing the complement of tenure-stream faculty members and librarians and/or providing increased salary and benefits to its academic staff. In particular, we tried to identify reliable sources of unrestricted funds that could be channeled into academic operations without putting the university's financial position at risk. Our key results are as follows:

1. After a significant dip in 2008, Mount Allison's stock of non-externally-restricted cash and investments has increased steadily over the past three fiscal years and stands at more than $11.5 million as at the end of the 2011-2012 fiscal year. The increase over the last two years has averaged $4 million per year. This level of "cash in the bank" is equivalent to almost 50% of total academic department expenses in 2011-2012.
2. This increase in cash and investments has been accompanied by consistent general operating fund surpluses in the range of $1.5 to $2 million per year over the last four years; and annual ancillary fund (bookstore, conference services, etc.) surpluses that have increased to $3.8 million in 2011-2012. The total unrestricted surplus generated by these two funds in 2011 – 2012 amounted to just less than 25% of total academic department expenses in that year.
3. The surpluses identified in point 2 above have largely been (1) internally restricted by the Mount Allison administration, which means that the funds are still unexpended but have been earmarked or set aside for some future purpose or purposes that are, for the most part, unidentified in the financial statements; or (2) transferred to, and invested in, Capital Assets (e. g., acquisition and/or renovations of land, buildings and equipment).

The Mount Allison Administration has been generating what appear to be substantial and sustained unrestricted surpluses every year, a large part of which is being put in the bank for some unspecified purposes. We can find nothing in the financial statements to explain why at least some of these surpluses cannot be used to support the operations of academic units through increased hiring and/or compensation increases for Mount Allison staff so that the university can continue to attract and retain highly qualified staff.

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March 5, 2013

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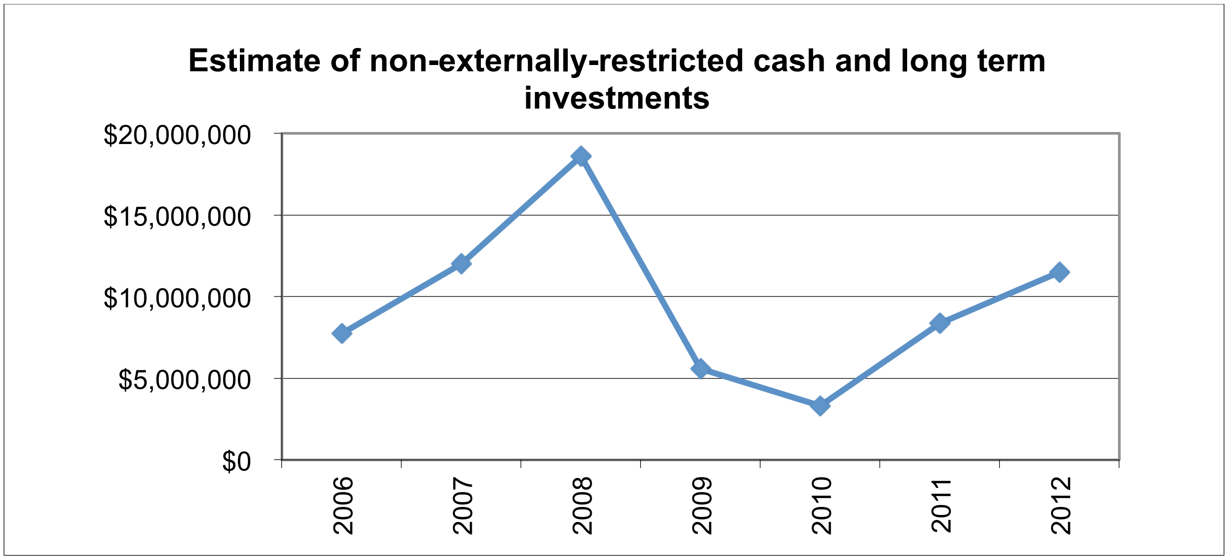
Universities, like most other not-for-profit enterprises, typically receive two sorts of funding. Unrestricted funds generally include government grants, student tuition fees and revenues from so-called ancillary services (e. g., student residence services, conference and catering services, campus bookstore sales). Unrestricted funds can be used for any purpose consistent with the mission of the organization and are generally those used to pay operating costs. Restricted funds can only be used for specific purposes, e. g., Capital (land, buildings, equipment) or Endowments. If the specific purpose is identified by a donor, the funds are considered to be externally restricted.

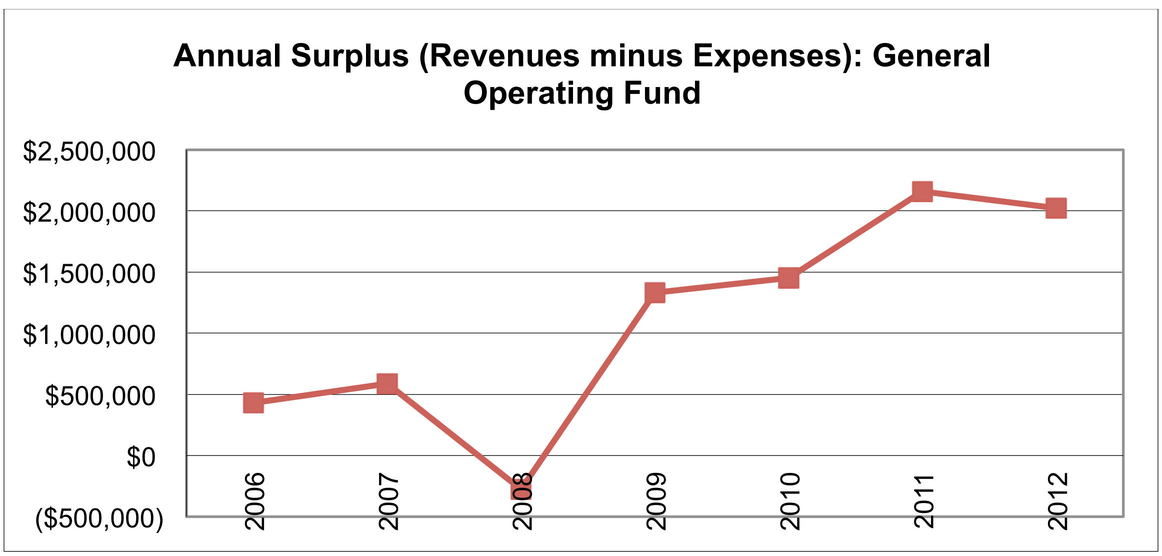
Our standard approach to analyzing university financial statements is to start by identifying Cash and Investments that are not externally restricted (see appendix for more information regarding our approach). Money to support improved support for academic departments and/or compensation for employees (aside from endowed chairs or similar funds that provide additional salary or support to select individuals or groups of employees) will have to come from these resources. Typically, the universities whose statements we have seen do not disclose this information and Mount Allison is no exception, but we can estimate it reasonably well.[1] Our estimate of the year-end balance in non-externally-restricted Cash and Investments over the past seven years is shown below:

[1] 2012 General Operating Fund Cash and Investments (estimated) = Cash and cash equivalents + Long term Investments – (Deferred contributions, total – Deferred contributions related to capital assets) – Net assets restricted for endowment purposes. At the end of the 2012 fiscal year, this amount was = $19,757,177 + 119,406,515 – (58,575,056 – 42,768,789) – 111,851,300 = $11,506,125. All amounts come from the statement of financial position (p. 3)



After a substantial drop in the period 2008 – 2010, the balance in non-externally-restricted cash and investments has increased by roughly $4 million per year in each of the last two years. This level of annual increase is substantial, equal to approximately 17% of total 2011-2012 Academic department expenses.

Where do these excess funds come from? Over the past four years, the General Operating Fund has generated surpluses totaling almost $7 million, as shown below:

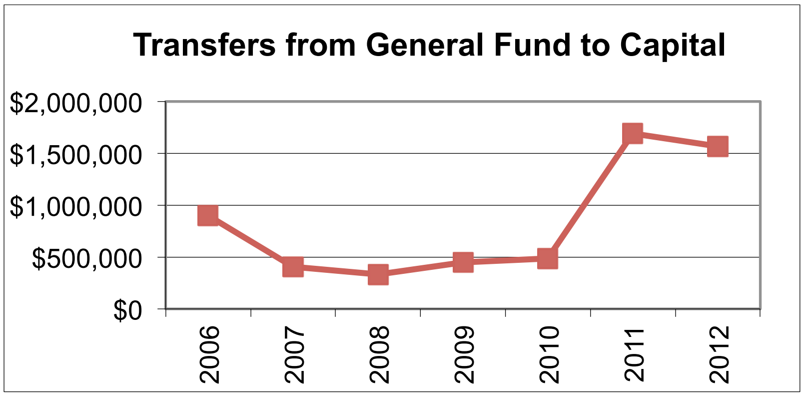


These surpluses have been relatively stable since 2008 and have been accompanied by increases in the University's stock of non-externally-restricted Cash and Investments.

There appear to be at least two question marks, however. First, the increases in these Cash and Investments are not perfectly correlated with the General Operating Fund surpluses. Secondly, the University's statement of financial position indicates that the Unrestricted Net Assets of the

University total only $17,307 as at the end of the 2011-2012 fiscal year in spite of the increase in non-externally-restricted cash and investments.

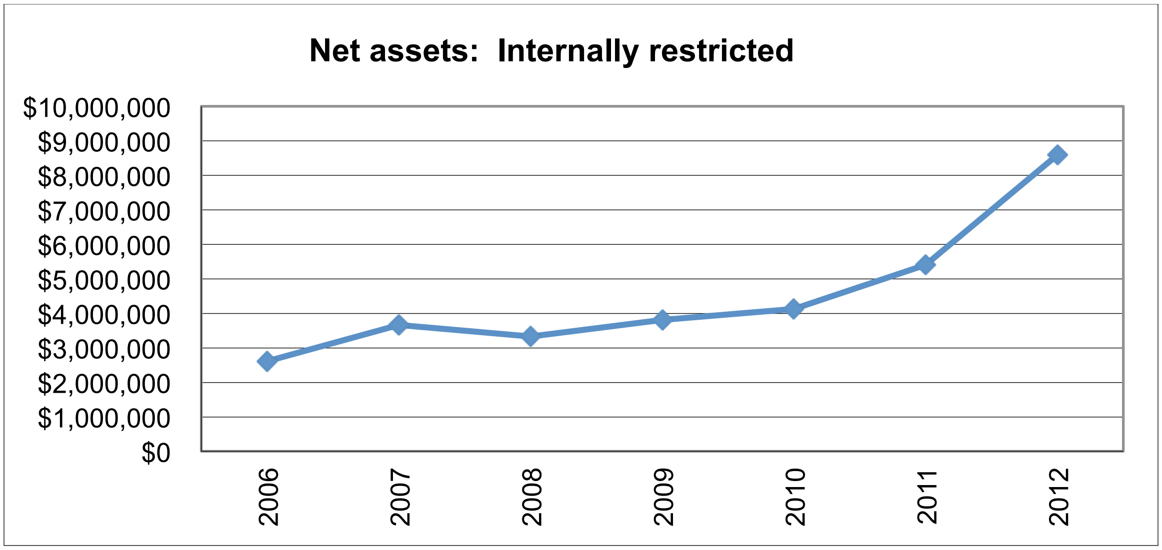
Our experience with other universities is that the administration can do two things to dispose of, or appear to dispose of, operating surplus: (1) Transfer the surplus resources to another fund, especially Capital; and/or (2) impose an internal restriction on the funds. Transfers from the General Operating Fund to Capital over the past seven years are plotted below:



These transfers represent General Operating Funds that have been diverted from current operating expenditures like salaries and benefits to acquisition and/or renovation of land, buildings and equipment. Note the significant increase in 2011 and 2012 compared to earlier years. This could be in part due to a change in presentation of financial statement information in 2011 that made the total amount of these transfers more transparent. There is a possibility, then, that the general-operating-fund-to-capital transfers that we identify from earlier years are understated.

An <u>internal restriction</u> implies a decision on the part of the University Administration to earmark unrestricted funds for some specific future purpose. Mount Alison does not give any information as to what these purposes might be, but the University of Manitoba, for example, restricts surplus funds for purposes like funding department and unit budget carryovers, a fiscal stabilization (or "emergency slush") fund, and computer equipment replacement. Funds that are transferred to Capital would be excluded from our estimate of unrestricted cash and long term investments (our first graph) as they are now restricted. In contrast, internally restricted funds remain "in the bank" even though the Administration has declared them unavailable for current operations.

Mount Alison's internally restricted net assets over the past seven years are shown below:



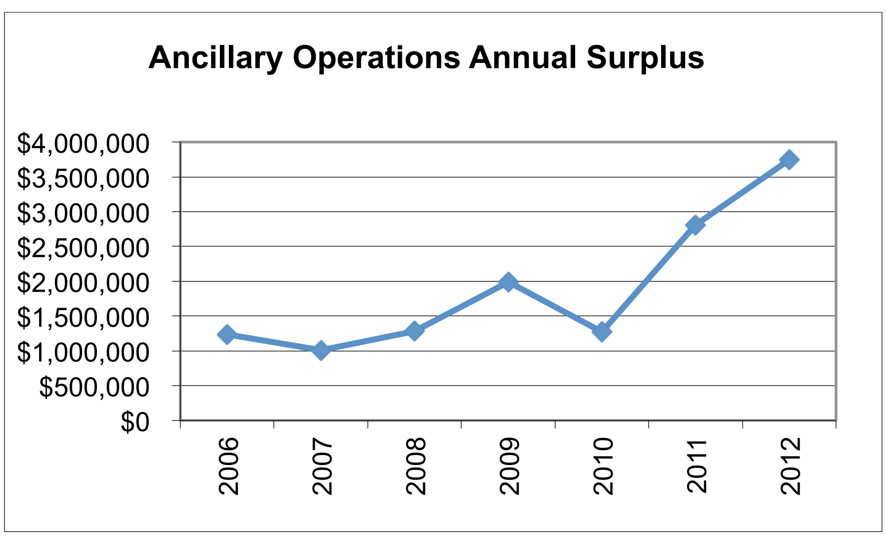
The amount of internally restricted net assets has more than doubled in the last two years, allowing the university to build up cash and investments while appearing to have no unrestricted resources left over to fund operations beyond current levels.

<u>Other sources of unrestricted funds</u>

Ancillary operating fund

Mount Allison distinguishes between revenues that come from General Operations (the central teaching and research functions of the university) and those that come from Ancillary Operations (bookstore, residence, dining, merchandise sales, etc.). See note 2a and Schedule 1 of the financial statements for more complete descriptions of the two funds.

The Ancillary Operating Fund generates considerable and growing surpluses, as shown below:

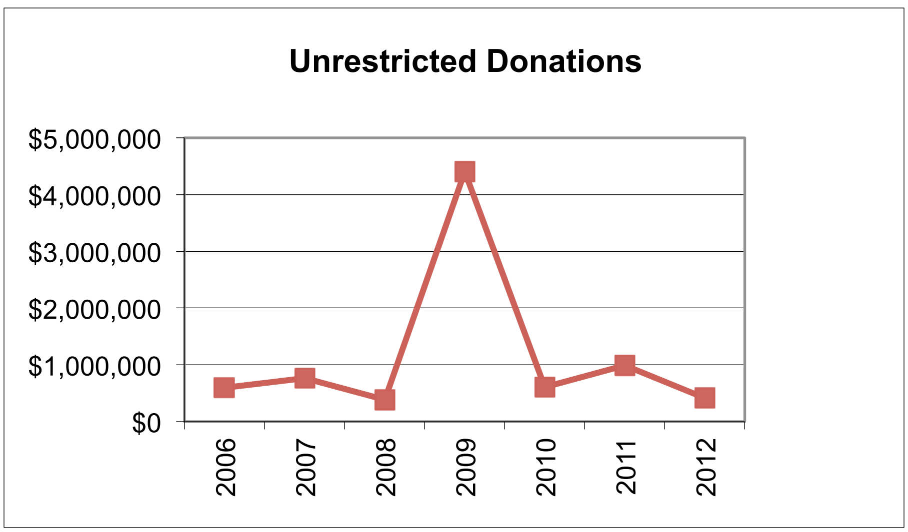


Ancillary Operations revenues are not externally restricted so they can be used to support the teaching and research activities that the University calls General Operations. Right now, that does not appear to be the case. According to note 2f, at least some of the Ancillary Operations surplus is appropriated for (transferred to) Ancillary-related capital projects – in 2012, this amounted to $1.2 million of a $3.7 million dollar surplus. The remainder ($2.5 million) was transferred to the Special Purpose Fund where it was internally restricted for some unspecified purposes.

The tendency to restrict Ancillary Operations surpluses rather than use them to fund General Operations is one that we have seen in other universities. The supporting argument is that the Ancillary Operations should be self-sufficient and allowed to use their surpluses to enhance their own operations. The University of Manitoba follows a similar approach. Consultants hired recently by the UM, however, advised that the UM should appropriate more of these surpluses for General Operations. (This was part of the first, easy set of cost efficiencies, what the consultants called “low hanging fruit”). It seems likely that these Ancillary Operations surpluses could provide sustainable funding for improved employee compensation.

Donations

Many donations are restricted by donors for specific purposes. Donations that arise from specific campaigns are typical examples. Mount Allison receives a substantial amount of unrestricted donations that could be used for any purpose. Unrestricted donations received over the past seven years are shown below.



Mount Allison’s policy with regard to Unrestricted Donations is not clear. Some of these donations are transferred to a University endowment fund, while some are transferred to some Special Purpose funds. 2009 was a particularly good year and over 90% of the $4.4 million in donations was transferred to Endowment. While the University appears to have a relatively good record in generating unrestricted donations, the inherent unpredictability probably argues against using these funds for increased employee compensation.

Other Observations

We include in this section some observations that may be helpful in assessing how prudent the Administration has been in their stewardship of the university's resources. First, we note that, like other universities, the Administration tends to be pessimistic with their budgets. In all years except 2008 (where large unanticipated investment losses occurred), the actual surplus exceeded the budgeted amount:

General fund only: comparison to budget ($ thousands)	2007	2008	2009	2010	2011	2012
Actual total revenues - budgeted (excluding transfers)	244	762	9	1,108	1,195	914
Actual total expenses - budgeted (excluding transfers)	(558)	139	(1,651)	(1,550)	(2,120)	(2,306)
Actual excess - budgeted excess	789	(279)	1,331	1,454	2,162	2,025

Note that our analysis looks at the surplus before transfers – as noted in our report, the Administration generally makes this surplus "disappear" by transferring it to capital or internally restricting it, thus creating a "bottom line" that is close to zero.

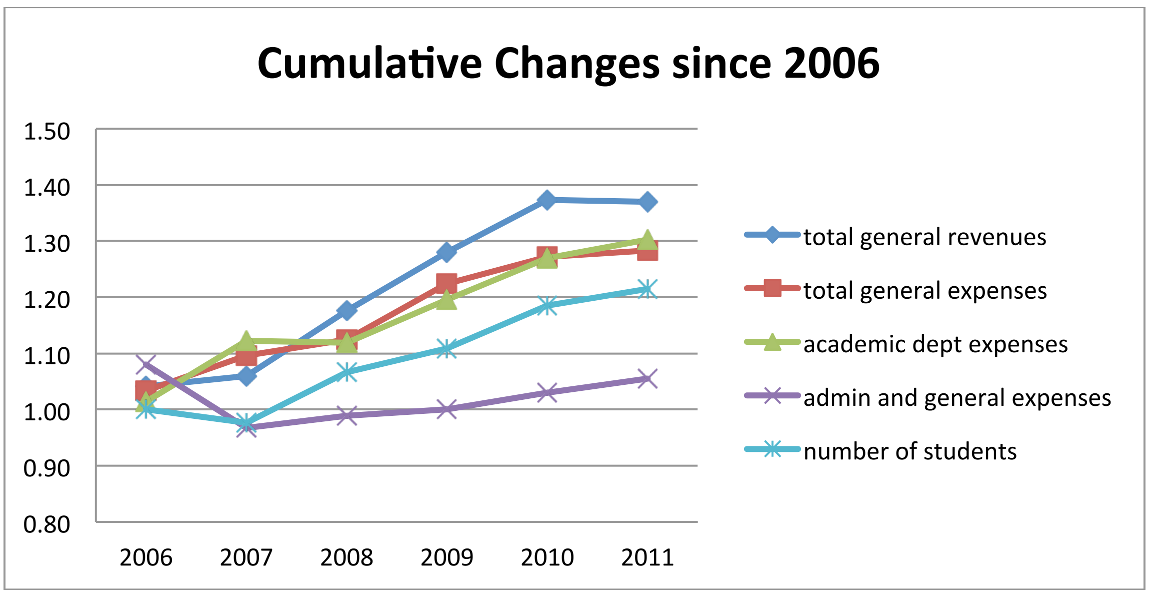
It is also noteworthy that most of the improvement of actual performance over the budget comes from decreasing costs rather than increasing revenues, as seen below:

General fund only comparison to budget (as a % of general fund operating revenues)	2007	2008	2009	2010	2011	2012
Actual total revenues - budgeted (excl. transfers)	1%	2%	0%	3%	3%	2%
Actual total expenses - budgeted (excl. transfers)	-2%	0%	-5%	-4%	-5%	-6%

In fact, it appears that Mt Allison has exercised firm control over costs over the period of our analysis. We tracked some particularly sensitive figures expressed as a percentage of general fund revenues:

	2006	2007	2008	2009	2010	2011	2012
Academic dept expenses %	41%	40%	44%	39%	39%	38%	39%
Admin and gen service expenses %	15%	15%	14%	13%	12%	11%	11%
Internally funded capital assets %	2%	1%	2%	2%	4%	6%	5%
Surplus %	4%	4%	0%	8%	8%	11%	10%

First, note that the surplus (before transfers) has been a larger percentage of revenues, indicating the strength of Mt. Allison's financial position. Academic department expenses have consumed a relatively stable, but slightly shrinking, portion of revenues which could be used as an argument in favour of increased salaries and/or increased hiring. Internally funded capital assets (capital assets financed with unrestricted funds) is taking increasingly larger portions of unrestricted revenues, consistent with the choices that many other universities have been making. While Mt. Allison's percentage of revenues diverted to capital assets is clearly increasing, it is still lower than many of the universities we have looked at. For example, in 2012 University of Alberta, University of Manitoba, and University of British Columbia all transferred more than 10% of their operating revenues to capital. Finally, it is interesting that administration and general service expenses have been decreasing as a percentage of revenues which is contrary to the direction of many other institutions. While this may be a sign of shrewd cost cutting, it may also raise questions.



Administration and general service expenses have declined despite many increases at Mount Allison: more students, more capital projects, and more money in the endowment to manage. Furthermore, the net decrease in administration and general service expenses may actually have been an *increase* in administration (common in most universities) and a very large *decrease* in general service expenses. Have these efficiencies resulted in a reduction in program quality, service to students, or a downloading of administrative responsibilities to academic faculty?

Appendix. Analyzing University Financial Statements

Our general approach to analyzing university financial statements is to identify the amounts and sources of resources available for additional support for academic teaching and research through, for example, increased employee salaries and benefits and hiring additional academic staff. We try to establish whether the university has unexpended resources that it could use to improve employee compensation and the sustainability of those resources (i. e., is there a reliable, continuing source of these resources?). The central questions we try to answer are:

- How much Cash and other liquid assets (investments) does the university have? How have those changed over time?
- If there are any surplus Cash and Investments, where does it come from?
- Why is the university not directing these funds to its faculty?

The first step is to identify the liquid assets (cash and investments) available to the university to pay employee salary and benefits. This is complicated because every university we have seen uses fund accounting, a system under which all of the university's assets and liabilities are divided among different funds according to the restrictions donors have placed on those funds. The funds used by each university will depend on its circumstances, but generally, all universities will have at least the following funds:

- **General or Operating Fund**: These funds are typically unrestricted, which means that the university can use them for any purpose consistent with the overall goals of the university. Employee salaries and benefits and other operating expenses are paid out of this fund. Principal sources of these funds (what accountants call *revenues*) are government grants, student tuition and fees, and ancillary service revenues (e. g., parking services, campus bookstore, student residences).
- **Capital Fund**: These are long-lived assets like land, buildings, equipment and library collections; as well as money received specifically to fund future acquisitions. Money in the capital fund can *only* be used to acquire and/or renovate assets like this. These funds can come from government capital grants and capital fundraising campaigns.
- **Endowment Fund**: These are funds that are established to provide money, sometimes for general operating purposes but often for specific programs, e. g., scholarships and academic chairs. What is unique about an endowment fund is that the original contribution (or capital - unfortunately, the same term used to describe land, buildings, etc.) must remain invested and only the investment income can be spent. Endowment funds often come in the form of bequests and other donations or specific endowment fundraising efforts.

Generally, university employee compensation is principally paid out of the Operating Fund. Universities typically present financial information on a consolidated basis whereby the balances within each fund are combined into a single figure. We need to rely on other disclosures to estimate what is in the Operating Fund. We have found that this is not always possible.

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