
SEBTS INTEROFFICE MEMORANDUM

TO: DR. PAIGE PATTERSON
FROM: RYAN R. HUTCHINSON
SUBJECT: INTERNAL FINANCIAL DISCUSSION
DATE: 12/02/99
CC: G. PAUL FLETCHER, DR. L. RUSS BUSH, DR. BART NEAL, & DR. N. ALLAN MOSELEY

This past fiscal year marks the end of a three-year conversion that the school has been going through in its internal financial record keeping. During this period, we have introduced a new accounting package that has allowed us to keep better records. There was a painful conversion process to this new package, but the result gave us cleaner books. In addition, during the period, we have changed our internal account structure twice. The last change was to bring our books inline with a statement on financial reporting (FASB 117) issued by the Financial Accounting Standards Board. We were pioneers in a step we took in changing our internal account structure. Many non-profit organizations are still using the old Fund Accounting procedures in house and having their books converted by their auditors every year to be able to present their financial reports to the standards set in FASB 117. However, our internal books now allow for one easy step from our General Ledger to our Financial Reports. We now have three categories that allow for easy tracking of the financial dealings of the school. The 'Unrestricted' category represents all monies available for the general operating expenses of the school. The 'Temporary Restricted' category represents all monies available that can be spent in their entirety for donor restricted purposes (i.e. – the Great Commission Center Gifts). Finally, the 'Permanent Restricted' category represents all monies that are used for endowment purposes to earn interest and support the school's financial aid and other operating expenses.

The past three years we have received very favorable reports from our external auditors on the financial condition of the school. However, internally we must examine the books more closely. The purpose of this memo is to communicate to the cabinet the financial condition of the school from the three different categories.

Permanent Restricted

The Permanent Restricted category represents our endowment monies that are board designated and externally designated for the purpose of earning interest to support the various endeavors of the school. For the purposes of the discussion on our Permanent Restricted funds, we will add in the Quasi-Endowment figures that are actually held in the Unrestricted category. The Quasi-Endowment represents funds that designated by the school for endowment purposes. Accounting principles do not allow us to hold those funds in the Permanent Restricted category since the school has the ability to change the designation of those funds at any time. Currently, our total endowment

is \$18.7 million. The portion of this figure represented by the Permanent Restricted endowment is \$13.1 million. Over the past three years, the Permanent Restricted endowment has grown by \$1.6 million. The breakdown of this growth is approximately 50% capital gains and 50% additional funds received. Of any non-profit educational organization, the endowment is the financial life-blood of the school. Without a significant increase in the endowment, the increase in our student services, plant, and educational services will become a large financial strain on the organization. We are already feeling the effect of this trend. Those strains will be noticeable once the Unrestricted situation is discussed.

Temporary Restricted

The Temporary Restricted category holds the funds designated by the donor to be spent in their entirety for a restricted purpose. It is also the category where the interest earned from the endowment for restricted purposes is recorded. Last fiscal year the Temporary Restricted category received \$234,000 in interest income from the endowment. The Temporary Restricted category released \$2.8 million dollars in funds to the Unrestricted category for purposes such as financial aid, Stephens/Mackie renovation, and other institutional support issues. As of November 29, 1999, after the expenses related to the renovation of Stephens/Mackie, we have a total of \$725,759.75 available for the Great Commission Center. This includes the \$352,624.62 that was received from the Ledford life insurance settlement. The total cost of Stephens/Mackie was \$1.3 million. A look at the Temporary Restricted category also reveals that we have cash on hand for the Magnolia Hill construction project totaling \$297,811.25. There are no serious issues to address in the Temporary Restricted category other than the possibility of charging ourselves interest for funds that have been borrowed by the Unrestricted category.

Unrestricted

The Unrestricted category represents the funds that are available for the daily operation of the school. It is in this area where we are in the most desperate need. Typically, an organization experiences fluctuations in their cash flow depending on their business cycle. The seminary's times of large cash flow is during August, December, January, and May. These months represent payments received for classes and payments received to clear previous balances so that students can graduate and matriculate for the next semester. In an attempt to improve cash flow, we implemented the FACTS tuition management plan. For tuition purposes, this plan has been very successful. We are experiencing on average a 95% success rate on the tuition payments. However, a comparison of August through November of 1998 and 1999 show that our overall collection rate has increased very little. The overall collection rate has increased from 86.98% to 88.98%. This shows that there has simply been an adjustment to how the students' are applying their payments. Of course if our entire A/R was operating at a 95% collection rate, it would mean that we would have collected another \$140,000 this year. Unfortunately, this would only represent a drop in the bucket of what is needed. This year we are on route to losing \$72,000 dollars on our Child Care Center bringing our total loss on this venture over four years to \$421,000. Through November, Housing has lost \$156,000. This is in addition to a loss of \$232,072.32 that Housing took last year.

Over the past three years, the working capital of the Seminary has dwindled to zero. This is because our fiscal growth has far outpaced the growth of our student population. The budget has grown over 73% in the past year while our non-duplicating head count has grown 38% and our projected FTEs would only amount to a 25% growth. What has compounded this disparity is that we went 15% over budget on our expenses last year while our income was only 4% over budget. This has been a trend over the past three years where we have disregarded our budgetary constraints and

depleted all of our reserves. Twice this year we have had to dip into our Temporary Restricted funds to meet our monthly payroll. In a few days, we will have need to borrow again. Disregarding the borrowing that will occur in a few days, the Unrestricted owes the Temporary Restricted \$241,000. After the next payroll that number will increase to \$620,000. The debt will be alleviated some due to our increase in cash flow over December and January, but as we enter the Spring months this number will rise again. In addition to the amount owed to Temporary Restricted, the Unrestricted owes the Permanent Restricted \$225,000. This is due to a gift that was recorded into Unrestricted funds and then later transferred on our books due to its restricted designation. However, we did not have the cash available to make this transfer.

This is a vital example of how our Endowment works with our daily operations. It is impossible for any education institution to charge a student what is necessary to support the organization. Without significant growth in our endowment, the effects are devastating when there is a period of monumental growth in our daily operating expenses. Over the past three years our endowment has grown by 13% while as previously stated our budget has grown by more than 73%. Last year we survived through a capital needs gifts from the Cooperative Program of over \$500,000. However, this year our capital needs funding is only \$300,000 and because of our current financial condition these funds are already depleted. In addition last year we received the Shearon life insurance settlement of approximately \$400,000. Thus it is evident that without the nearly \$1 million in extra-budget receipts our financial condition would be much worse.

Unrestricted working capital serves as the foundation of any non-profit educational institution to support it through its slower times of cash flow and higher than expected expenditures. We are treading on dangerous ground as we use funds restricted for other purposes as our working capital.

Recommendations

How can we rectify the financial problems that we are experiencing?

- 1) Begin a vigorous campaign to infuse our endowment with much needed funds. In comparison to our institution size versus our other large seminaries, we really need at least \$80 to \$100 million in endowment. Our efforts over the past few years have been directed toward raising funds for renovation and construction, but we have not had the needed growth in our endowment to support the future expenses related to our plant growth. Our endowment campaign must be carefully planned out to ensure that the funds are directed to the purposes needed for the entire operation of the seminary.
- 2) The Child Care Center should be closed due to its decline in enrollment and continued inability to support itself financially. It appears that the majority of those using the services of the Child Care Center are not Seminary related (60%). In addition, we would experience a decline in our liability insurance. It would be possible for Seminary related child care to shift to a "Child Care Network" where arrangements could be made for our stay-at-home mothers to earn some extra income while providing a valuable service to other Seminary families. An investigation can be done to determine what are the legal limits for in-home care without having to establish a daycare status.
- 3) We should examine the Housing administrative center to determine what needs to be done for it to be able to support itself and not be a financial drain on the Seminary. We may be faced with raising rent again, but other alternatives should first be examined before we insight a student revolt over rent costs.

- 4) Each administrative center needs to stay within their budget. This must become a corporate cause to ensure that we do not drive our Unrestricted category into more debt. If there is a conscious effort to hold back unnecessary expenses, we may be able to end the fiscal year minimizing our Unrestricted debt. In this effort, we should place all contracts up for bid to make sure that we are getting the best service for our money.
- 5) This year it will be necessary for us to sell the property on Capital Blvd. This \$8 million dollars will be necessary to give us the support that we need. I suggest that we take \$1.5 million of these funds to pay back any debt that the Unrestricted category has incurred. \$2 million can be used to establish a technology endowment giving us at least \$70,000 the first year and at least \$100,000 after the 10th year. Another \$2 million can be designated for missions support. This will produce the same amount of income as the technology endowment and allow our Church Planters to have scholarships while they are overseas. The current Church Planters have this benefit, but due to the decrease in available funds it will not be available to future deployments. Another \$1.5 million can be used to provide additional student aid and the final \$1 million can be used as an endowment for general institutional support.
- 6) There is another possibility for which to use the land sale monies. We can take the first \$1.5 million to settle our Unrestricted needs and use the endowment income from the other \$6.5 to pay our housing loans down early. If we take this measure, will we pay off our housing loans in 13.5 years instead of 20, and we will only spend \$7.7 million in interest rather than \$12 million. This will save an out of pocket expense of \$4.3 million.
- 7) Finally, I suggest that we hold off any budget growth for two years. If we close the Child Care Center and do not replace it with another expenditure, we will be able to cut our budget back by \$350,000. While this is a small step it will allow us to make a significant cut without placing the needs for large budget cuts on our other administrative centers. With next year's jump in Cooperative program funds and the increase in our student population, the continual loss of our Unrestricted monies will hopefully be curtailed. However, it would be a smart idea for all administrative centers to consider ways of cutting their budgets by 3-5% this upcoming year.