I. Introduction

The Administrative Procedures and Standards serve to interpret and clarify the policy on Financial Sustainability for State System universities. The System Standards and Procedures are designed to further define or explain the policy, not to impose any new requirements that are not otherwise set forth in the policy.

II. Definitions

The definitions listed below include all the indicators identified within the policy as well as additional definitions needed for this procedures document. While all indicators within the policy will be utilized by a university to manage operations, financial risk and to assist with the financial sustainability planning process, only four (4) indicators will be utilized to provide insight into a university's financial health as outlined within these procedures. The four (4) indicators are defined below as procedure indicators.

Procedure Indicators

1. Enrollment Indicators—Demographic changes have resulted in the increasing role of enrollment as a leading indicator for financial health. Enrollment, for the purposes of this procedure, includes historical data representing the actual prior years’ figures and projected data as reported by each university.

   Annualized Student FTE (Fulltime Equivalent): Measure that combines full- and part-time student credit loads and equates those totals to an annual full-time equivalency. Student FTE is derived from Student Credit Hours, through university course enrollment details for all courses in an academic year (July 1 through June 30, which includes Summer 2, Fall, Winter, Spring, Summer 1).

   • An annual Student FTE for Undergraduate Instruction = 30 Credit Hours.
   • An annual Student FTE for Graduate Instruction = 24 Credit Hours.
**Projection**—Projection data will come from the Goal Alignment Workbook completed by each university, supplemented by enrollment projections in the BUDRPT (Budget Report).

2. **Operating Margin Indicator**—Operating margin is an indicator of efficiency which shows the impacts of both pricing and operational decisions on financial health. It is recommended by NACUBO (National Association of College and University Business Officers) that the operating margin ratio be within 2-4 percent.

   i. **Operating Margin Ratio**: Annual revenues minus annual expenses divided by the annual revenues.

      **Expenses**: Expenses as defined by the Governmental Accounting Standards Board (GASB), including accruals, but excluding the noncash Pension in excess of pay-as-you-go expenses and noncash Other Postemployment Benefits (OPEB) in excess of pay-as-you-go expenses (both resulting from the respective actuarial calculation) and the annual noncash compensated absences adjustment. Depreciation is included but capital expenditures are excluded.

3. **Primary Reserve Ratio Indicator**—The primary reserve ratio is an important indicator of financial health showing how long an institution could function using its expendable net assets. It is recommended by NACUBO that the primary reserve ratio be 0.40x or 40 percent or greater.

   i. **Primary Reserve Ratio**: Expendable financial resources (unrestricted plus temporary restricted) divided by annual operating requirements (total expenses).

4. **University Minimum Reserves Indicator**—The minimum reserve is an indicator of a university’s ability to mitigate current and future risk and improve fiscal management.

   i. **University Minimum Reserves**: Cash within all funds, with the exception of restricted and agency, to cover at a minimum 90 days of operating expenses based on prior year financial statement.

**Additional Definitions**—The following section provides additional definitions for use within the procedures.

1. **Revenue**: Total revenues include both operating and nonoperating revenues as reported on the Statement of Revenues, Expenses and Changes in Net Position in the financial statements.

2. **Assets/Liabilities**

   i. **Net Position**: The net result of a university’s assets, plus deferred outflows of resources, less liabilities, less deferred inflows of resources, as defined by GASB. Net position increases when a university’s annual revenues exceed its annual expenses and decreases when a university’s annual expenses exceed its annual revenues. Net position is reported on the annual financial statements in three
categories: net investment in capital assets, restricted, and unrestricted.

ii. **Unfunded Liabilities:** Unfunded liabilities are the sum of the current and noncurrent net pension liability, OPEB liability, compensated absences liability, and the related deferred inflows of resources, net of the related deferred outflows of resources, as defined by GASB.

3. **Projected Cash Balances**

   i. **Unrestricted Cash Balances:** Unrestricted cash balances which include E&G (Education and General), auxiliary, and plant cash. In general, unrestricted cash balances are cash balances over which the university can exercise discretion in meeting the general financial obligations of the institution. Unrestricted cash balances do not include cash received from restricted gifts, restricted grants, or agency funds.

4. **Board Affirmed Metrics**—The following metrics affirmed by the Board of Governors shall be used with other data as part of a University Sustainability Plan.

   i. **Student Support Ratios:**

      **Annualized FTE Ratio:** A measure of productivity, calculated by dividing student FTE by the total faculty FTE, based on the faculty workload within the fall and spring terms. The total faculty FTE calculation includes the total number of faculty instructional contract hours, including both direct instructional (teaching) and indirect instructional (non-teaching, but instructionally related) contract hours, as well as contract hours associated to noninstructional alternative workload activities. The student FTE is derived from the course credits attempted during fall and spring enrollments.

      **Annualized Instructional FTE Ratio:** A measure of direct instructional productivity, calculated by dividing Student FTE by the direct instructional faculty FTE, based on fall and spring terms. The faculty FTE calculation is comprised of the total number of faculty associated to direct instruction (teaching) contract hours. The student FTE is derived from the course credits attempted during fall and spring enrollments.

      **Headcount Ratio:** Number of students per one faculty member. Calculation performed: Student Headcount divided by Faculty FTE, performed per fall and spring term.

   ii. **Student to Non-Faculty Ratio (FTE ratio):**

      **Annualized FTE Ratio:** Number of FTE students per one FTE staff member. Calculation performed: Student FTE divided by staff FTE.

      **Headcount Ratio:** Number of students per one staff member. Calculation performed: Student Headcount divided by Staff Headcount, performed per fall and spring term.

   iii. **University Debt Ratio:** The availability of expendable net assets to cover debt, should the institution need to settle its obligations. Calculation performed:
Unrestricted and expendable net assets, not including capital projects expendable net assets, divided by total debt.

iv. **Education and General (E&G) Expenditures per Student FTE**: The Education and General Fund consists of all unrestricted resources used in support of the primary academic mission of the university, with no restrictions placed on them by outside agencies. Expenditures are inclusive of all personnel compensation and benefits, as well as all operational expenditures consisting of supplies and services and capital expenditures incurred by the university within a given fiscal year from July 1 through June 30. Calculation performed: Annualized Student FTE divided by E&G Expenditures.

v. **Retention Rate (second fall)**: The percentage of fall first-time, full-time, baccalaureate degree-seeking students who return for following fall term.

vi. **Graduation Rates (completions)**: Percentage of fall first-time, full-time, baccalaureate degree seeking, undergraduate students receiving a bachelor’s degree within four and six consecutive years. Student segments are based on status of entering fall term.

5. **Financial Insolvency**—The university’s net position, excluding the unfunded liabilities, is negative, as reported in the audited financial statements.

6. **Liquidity Loan**—Loans providing temporary cash for operations for universities that have declining cash balances, and are to be repaid according to loan agreements, which include loans from within university accounts (intra-university) and loans from within the System.

7. **Investment Initiative**—Start-up funding for strategic or innovative investments to enhance a university’s success, which must comply with established reinvestment agreements.

8. **Financial Sustainability Plan**—A plan developed by the university through a process that relies on diverse stakeholders across the university community which addresses the core challenges confronting the university. The plan must be presented utilizing the standard template (see Appendix A).

9. **Peer University Consulting**—A diverse group of subject matter experts identified by the chancellor’s office, in coordination with the System’s Executive Leadership Group (ELG), and drawn from system universities or external resources to be utilized based on issues specific within the Financial Sustainability Plans.

### III. Procedure/Standard

A. **Procedure**—The four indicators outlined in the above definitions will be analyzed jointly by the Chief Academic Officers (CAOs) and the Chief Financial Officers (CFOs) at least annually to make an initial recommendation of where the university lies across the financial spectrum based on all four indicators. At a minimum, annually the following will occur:
1. An analysis will be conducted across the indicators with input from the university.
2. A recommendation will be presented to the university president and the Council of Trustees for review and commentary.
3. The recommendation, inclusive of all feedback, will be presented by the president to the ELG for appropriate review and action.
4. Depending on where a university falls across the spectrum, additional actions may be required as defined below.

B. Financial Spectrum Categories

1. Overall Stability:
   i. The following are characteristics across the multiple indicators of universities in this category:
      1. Enrollments have remained relatively stable (less than a 2% decline) or increased in the past two years and projections indicate stability or growth.
      2. A university’s annual operating margin is 2 percent or higher (3-year moving average).
      3. University’s Primary Reserve Ratio is 40 percent or higher (3-year moving average).
      4. University reserves meet or exceed 180 days cash on hand.
   ii. Triggers and actions: None.
   iii. The university is eligible to apply for assistance from the Investment Fund in order to pursue strategic or innovative initiatives that are intended to strengthen the university’s financial stability.

2. Financial Sustainability Plan One:
   i. The following are characteristics across the multiple indicators of universities in this category:
      1. Enrollments have decreased between 2-5 percent in the past two years and projections indicate continued decline.
      2. A university’s annual operating margin is between 0-2 percent (3-year moving average).
      3. University’s Primary Reserve Ratio is between 20 percent and 40 percent (3-year moving average) and trending downward.
      4. University reserves are between 90 and 180 days cash on hand.
   ii. Triggers and actions:
      1. Based upon the analysis and recommendation outlined in Section III A, if it is determined by the ELG that a university is within this category, a Financial Sustainability Plan will be required to be submitted to the CAOs and CFOs for initial review and feedback. This group’s feedback may include recommendations for Peer Consulting as well as the frequency of follow-up reporting on compliance.
2. The Financial Sustainability Plan and CAO/CFO feedback will be presented to the university president for presentation to the Council of Trustees for review and commentary, with periodic updates as appropriate.

3. The Financial Sustainability Plan and all feedback will be submitted by the university president to the ELG for awareness and additional comment (refer to Appendix A).

iii. The university is eligible to apply for assistance from the Investment Fund in order to pursue strategic or innovative initiatives that are intended to strengthen the university’s financial stability.

3. Financial Sustainability Plan Two:

i. The following are characteristics across the multiple indicators of universities in this category:
   1. Enrollments have decreased between 5 and 10 percent in the past two years and projections indicate continued decline.
   2. A university’s annual operating margin is negative (3-year moving average).
   3. University’s Primary Reserve Ratio is between 0 percent and 20 percent (3-year moving average) and trending significantly downward.
   4. University reserves are between 30 and 90 days cash on hand.

ii. Triggers and actions:
   1. Based upon the analysis and recommendation outlined in Section III A, if it is determined by the ELG that a university is within this category, a Financial Sustainability Plan will be required to be submitted to the CAOs and CFOs for initial review. This group will provide feedback which will include recommendations for peer consulting as well as the frequency of follow-up reporting on compliance.
      a. The Financial Sustainability Plan may require any or all of the following components including but not limited to:
         i. Identification of new and alternative revenue streams.
         ii. Review of Board Affirmed Metrics (defined above) to address prescribing cost-cutting measures such as limitations on discretionary spending, workforce reductions, closure of facilities, program curtailment, realignment of academic program offerings, and elimination of services.
         iii. Consideration of furlough and retrenchment options in accordance with collective bargaining agreements, as appropriate.
         iv. Consideration of outsourcing administrative functions to third-party vendors, other System universities (if the receiving system president agrees), the Office of the Chancellor, or
System/regional shared services (if participating presidents agree), in accordance with collective bargaining agreements, as appropriate.

v. Consideration of restricting the hiring of new employees or entering into new contracts.

vi. Consideration and prioritization of operating capital needs and identifying resources to meet needs.

vii. Leveraging the ability for a loan between auxiliary and E&G funds within the university’s funds. All intra-university loans must utilize the loan template (Appendix B).

2. The review and feedback will be presented to the university president.

3. The Financial Sustainability Plan and CAO/CFO feedback will be presented by the president to the Council of Trustees for review and commentary.

4. The Financial Sustainability Plan and all feedback will be submitted by the university president to the ELG for awareness and additional comment.

5. The president shall provide various reports as required by the chancellor/designee as deemed necessary for the monitoring of progress, until the university is no longer determined to be in documented stress. The chancellor shall provide periodic status reports to the ELG, the Board of Governors, and respective Council of Trustees.

iii. The university is eligible to apply for assistance from the Investment Fund in order to pursue strategic or innovative initiatives that are intended to strengthen the university’s financial stability.

4. Financial Sustainability Plan Three:

i. The following are characteristics of universities in this category across multiple indicators:
   1. Enrollments have decreased greater than 10 percent in the past two years and projections indicate continued decline.
   2. A university’s annual operating margin is consistently negative year over year (3 year moving average).
   3. University’s Primary Reserve Ratio is negative year over year.
   4. University reserves are less than 30 days cash on hand.

ii. Triggers and actions:
   1. Based upon the analysis outlined in Section III A, if it is determined by the ELG that a university is within this category, an assessment shall be provided to the university president, the respective Council of Trustees and the Board of Governors.
   2. Once a university has been determined to be in this category, the Board of Governors shall authorize the appropriate course of action to include the following:
      a. Authorize a liquidity loan if there is reasonable evidence of potential future financial sustainability. Revenue anticipation, such as anticipated or planned increases in
enrollment, tuition, fees, or appropriation shall not be considered to be evidence of future financial sustainability, without sufficient empirical support of the veracity of the increases.

b. If a liquidity loan is needed, specific procedures and conditions shall apply, such as must have first considered intra-university loans, expended reserves, and implemented the Financial Sustainability Plan actions.

c. The university shall comply with any restrictions or requirements established as a condition of receiving the liquidity loan.

d. The loan shall be repaid in full, with interest, based upon the terms of the agreement as outlined in a promissory note.

3. The president shall provide various reports, as required by the chancellor, until the university is no longer determined to be in financial insolvency. The chancellor shall provide periodic status reports to the ELG, the Board of Governors and respective Council of Trustees

IV. Implementation

A. Any changes to procedures, standards, and guidelines shall be promulgated by the chancellor after consultation with the ELG and Board of Governors.

Effective Date—Immediately.
Appendix A

Financial Sustainability Plan Templates - Plan One, Plan Two, Plan Three

Section 1 - Revenue Planning

Section 2 - Expenditure Planning

Section 3 - Financial Projections
Appendix B

Funds may be transferred to Educational & General funds on a temporary basis to support those operations when needed. Terms for the temporary loan, including interest charged and other provisions are specified in the Auxiliary/E&G Fund University Loan Promissory Note attached to this procedure. A copy of the executed note shall be sent to the Vice Chancellor of Administration and Finance in the Office of the Chancellor.

Promissory Note

**University of Pennsylvania**

**Auxiliary/E&G Fund University Loan**

THIS Promissory Note, made and entered into this \text{\text{\text{Xth}}} day of \text{\text{xx}}, 201\text{\text{X}}, between the \text{X} University of Pennsylvania’s auxiliary/educational and general Fund (E&G) Fund as lender, hereinafter referred to as the Lender, and \text{X} University of Pennsylvania’s auxiliary/E&G Fund as borrower, hereinafter referred to as the Borrower.

WHEREAS, the Borrower desires to borrow up to $\text{XX}\text{,XX}00,000 from the Lender’s Cash Balances as a line of credit, to be drawn upon in any or all amount, as needed by the Borrower, for a term not to exceed \text{three years} for each draw. The draw(s) shall be repaid in accordance with an amortization schedule determined at the time of the draw, at an initial interest rate of \text{XX}\% per annum, set annually in accordance with the System’s overall interest rate [Note: Treasury can provide the current rate]. In consultation with the Borrower, payment may be requested by the Lender at an earlier date, with interest calculated as described above, and

WHEREAS, the Borrower’s request has been duly approved by the President and the Council of Trustees has been notified of this internal loan,

NOW, THEREFORE, for and in consideration of the foregoing, the Borrower makes the following covenants:

1) The Borrower agrees that the principal and any and all accrued interest will be paid by a transfer out of its operating account in accordance with schedule described above, or as requested by Lender. The interest rate will be adjusted annually, as provided by the Treasury Office, Office of the Chancellor, Pennsylvania’s State System of Higher Education.

2) The Borrower agrees to record a "mandatory transfer from auxiliary/E&G" on the effective date of each draw and a "mandatory transfer to auxiliary/E&G" for each payment (principle and interest) to the Lender.

3) The Borrower agrees to reflect all anticipated draws and payments in its annual budget projections.
IN WITNESS WHEREOF, the signatories hereto have caused this Promissory Note to be executed the date first above-written.

_____________________
President
University of Pennsylvania

_____________________
Vice President for Finance and Administration
University of Pennsylvania