

TITLE: Special Appropriation Request

DESCRIPTION: Staff recommends that the Finance Committee review and endorse the proposed Special Appropriations request, and request approval by the full Council at its November 5, 2021 meeting.

PRESENTER: Bill Payne, Vice President of Finance and Administration, CPE

DESCRIPTION

In July of 2021, Kentucky State University (KSU) staff members alerted the KSU Board of Regents about a number of financial concerns. The Board then informed the Kentucky Council on Postsecondary Education (CPE) and the Governor's Office. Those financial concerns led to a leadership transition at the University on July 20, 2021.

That same day, Governor Andy Beshear issued Executive Order 2021-504, which directed CPE to provide an assessment of the current financial status of KSU, and provide a report to the Governor detailing its assessment prior to providing recommendations concerning appropriations for the next biennial budget.

KSU financial statements indicate that the university's cash position began to deteriorate in fiscal 2017-18. Prior to 2017-18, cash as reported in the financial statements remained stable at a level between \$18 and \$20 million before declining to \$14 million in fiscal year 2017-18. Cash then declined precipitously to between \$2 and \$3 million in fiscal years 2018-19 and 2019-20. Audited financial data are not available for fiscal year 2020-21, but a review of year-end bank balances and unpaid invoices indicate that the cash position will likely show a further decline.

During the period that cash declined, current liabilities (accounts payable, lines of credit, accrued absences, current portion of long-term debt) increased significantly as well. Current liabilities averaged approximately \$8 million per year until fiscal year 2018-19 when they increased to \$12.3 million and then to \$18.3 million in fiscal year 2019-20. For Fiscal 2020-21, current liabilities will remain in the \$15 to \$19 million range, pending completion of audited financial statements.

The combination of declining cash balances and increasing current liabilities have resulted in a significant liquidity crisis for KSU, with the university increasingly relying on

lines of credit, beginning in the third quarter of fiscal 2019-20. By the third week of July 2021, only \$2.8 million in cash was available for use, with no significant revenue anticipated until September. Further complicating the problem, approximately \$3 to \$4 million was owed to vendors, \$5.2 million was owed to the state, with payroll averaging \$3 million per month.

To manage this crisis, the university worked with the CPE and the Office of the State Budget Director to advance the university's fourth quarter General Fund allotment of \$5.4 million. The university also implemented a debt forgiveness plan using CARES Act funding, essentially paying \$2.5 million in outstanding student balances. This one-time action also provided much needed liquidity during this period.

KSU employed a number of measures prior to the close of fiscal year 2020-21 to meet expenses. CPE's report on the financial status of KSU will go into greater detail, but some of these measures are listed below:

- **Delaying payment to vendors.**
- **Failure to reimburse state construction accounts.** Beginning in 2019, the university stopped providing reimbursements to the state, and apparently used the cash from the drawn down federal funds for working capital.
- **Inappropriate draws from the university endowment.** The university maintains in its investment account the university endowment, which was originally funded from various sources. The university does not have a full set of donor agreements on file or clear information about the requirements of those endowment accounts in all cases. However, beginning in 2019, the university drew down approximately \$1 million in earnings per year, ostensibly for scholarship support. However, only approximately 43% of endowment earnings can be used to support scholarships.
- **Draws from Revenue Anticipation Notes.** While revenue anticipation notes are a legitimate way to provide short term liquidity for entities that receive cash revenues sporadically throughout the year, KSU did not close and settle these notes as required by year-end for several years. The balance on the note grew over those three years, reaching \$5 million before it was settled in July 2021.

As a result of the liquidity situation outlined above, the university has very little left in reserves. Expenditures have exceeded revenues by over \$35 million over the past four years and have depleted both the unrestricted university fund balance and unrestricted asset balances.

In July and August, the university operated with approximately 13 days cash on hand. This has improved in September to approximately 24 days cash, though most experts would consider 90 days cash on hand to be the minimum level of cash reserves required for a university, with 180 days more typical. Current projections indicate that all cash reserves will be depleted by the end of March 2020.

The use of a revenue anticipation note would allow the university to operate late into April, but at that point, no remaining sources of cash other than an additional appropriation from the General Assembly, would be available. Without a special appropriation, KSU will have a cash deficit \$23.0 million by June 30, 2022. Listed below is a snapshot of KSU's current financial status that was verified and presented to the KSU Board of Regents by CPE staff on October 19, 2021.

Deficit construction accounts with State Finance Cabinet	\$ 5.2 million
Prior year invoices paid in FY 2022	4.3 million
Asset Preservation Fee Receipts Not Reserved (2019-21)	1.2 million
July Repayment of prior year Revenue Anticipation Note	<u>5.0 million</u>
FY 2022 Cash Shortfall due to prior year deficits	\$15.7 million
Structural Imbalance in FY 2022 University Budget	<u>7.3 million</u>
FY 2022 Total Projected Cash Shortfall	\$23.0 million

- Council staff recommends a nonrecurring General Fund appropriation of \$23,000,000 in fiscal year 2021-22 and recurring appropriations of \$1,000,000 each year of the 2022-24 biennium to provide ongoing financial stability and support targeted strategic initiatives at Kentucky State University.*

As can be seen in Table 1, staff recommends that the Council's special appropriation request include two funding components for Kentucky State University: (1) a financial stabilization fund; and (2) strategic operating funds. The stabilization fund is necessary to address a current year structural deficit and allow the university to pay vendors, reduce debt, and achieve financial stability. The request for strategic operating funds will support the expansion of teacher education and public administration programs at KSU, which is well aligned with state student success goals and with objectives and strategies in the Council's *2016-2021 Strategic Agenda for Postsecondary Education*. Additional information about these funding components is provided.

Table 1: Components of 2022-24 Special Appropriation Request

Funding Component	Fiscal Year 2021-22	Fiscal Year 2022-23	Fiscal Year 2023-24
Additional Budget Requests:			
Financial Stabilization Fund (NR)	\$23,000,000	\$0	\$0
Strategic Operating Funds	0	1,000,000	1,000,000
Total Additional Requests	\$23,000,000	\$1,000,000	\$1,000,000

NR = Nonrecurring funds

Financial Stabilization Fund

The financial stabilization fund will be used to manage KSU through fiscal 2021-22, and will allow the institution to pay vendors promptly and reimburse the state’s construction account. CPE will ask that these funds be placed in a newly created Funding Program for KSU and be released to the university only after CPE verifies that proper financial controls are in place, as outlined in a new Management and Improvement Plan.

Strategic Operating Funds

The strategic operating funds requested will provide KSU with resources of \$1.0 million in each year of the upcoming biennium to expand and improve two of its signature programs: Education and Public Administration. As a primarily liberal arts institution and a historically black college or university (HBCU), KSU is well positioned to help the Commonwealth meet its needs for a more diverse K-12 teacher corps, which is necessary to educate students in an increasingly diverse school environment and world. KSU’s location in the state capital also makes investment in public administration programs a worthy pursuit. As will be detailed in the Management and Improvement Plan, KSU will submit annual reports to CPE detailing the uses of these funds and the results of the investment.