HARDIN-SIMMONS UNIVERSITY
BOARD OF TRUSTEES

Financial Update to the HSU Family

November 10, 2020

The COVID-19 pandemic has disrupted every facet of our lives. Things we took for granted – going to church on Sunday morning and stopping at our favorite restaurant – have often been replaced with online worship and drive-through lanes. When it is time for class, students frequently open their computer rather than grab their backpack and books.

Disruptions caused by the pandemic have also impacted the financial health and well-being of numerous businesses and institutions. Many of our alumni, friends and supporters have asked if these disruptions have impacted HSU's financial health and strategic plan. We are pleased to report that, while the university has not been immune from COVID-19 induced effects, because of the hard work and sound financial decisions during the last few years, Hardin-Simmons University remains well-positioned financially for stability and sustained growth.

The mission of Hardin-Simmons University is "to be a community dedicated to providing excellence in education enlightened by Christian faith and values." In recent years, fulfilling that mission was in serious jeopardy due to large ongoing operating deficits which, for decades, were funded through bank borrowing and by spending unrestricted quasi-endowment funds or "rainy day savings," as approved by various past Boards of Trustees. Due to the significance and longevity of the operating deficits, HSU's borrowing capacity from both banks and the quasi-endowment was mostly depleted by 2017. The university found itself on an unsustainable financial path which jeopardized its mission, legacy, and future existence.

Financial Sustainability. As a result, the current administration, at the direction of the Board of Trustees — the Finance Committee, in particular — instituted a program to develop a cost to revenue alignment and to set a course for achieving financial sustainability. The resulting action plan includes investing for growth, restructuring or eliminating unprofitable degrees, and reducing operating costs.

Implementing these financial decisions and actions, while necessary, has been extremely difficult and painful. Various programs are being closed because they were no longer financially viable or sustainable long-term and therefore contributed to the university's ongoing year-after-year operating losses, an untenable situation which had to be remedied. Also, as part of fulfilling their fiduciary duties, the trustees committed to stop spending quasi-endowment funds, those functioning as the university's long-term savings account, to keep these programs afloat.

The university endeavors to be good stewards of all the funds entrusted to it, even if that requires difficult decisions. Every decision to eliminate a program or activity is difficult since it directly impacts large numbers of people. The Board strived to lessen the impact with generous contract buyouts and other severance benefits, but valued employees were still adversely impacted. The loss of a professor or a cherished program causes pain to our alumni and supporters, and many have asked if there was not an alternative. As we explained last summer, after countless hours of prayerful analysis and consideration, the trustees, many of whom are financial experts and experienced businesspeople, determined that the university's long-term financial stability could only be achieved by focusing resources on financially viable programs and by updating our physical facilities.

Hardin-Simmons University is now seeing the positive financial impact of those decisions. HSU's operating deficits are declining and currently tracking to a minimized operating loss in the current Fiscal Year. Further, to cover operational costs, HSU is now relying less on temporary borrowing from banks or from the quasi-endowment.

Audited Financial Statements. Hardin-Simmons maintains its books and records according to Generally Accepted Accounting Principles (GAAP), and financial statements are prepared according to Financial Accounting Standards Board (FASB) required formats. Every year an independent third-party accounting firm audits HSU's financial statements. For the last several years, auditors have issued an unqualified opinion, also referred to as a "clean audit". That is, the auditing firm concluded the financial statements presented fairly the results of the university's operations and its financial position according to GAAP. As explained more fully below, the most recent audit once again resulted in a clean audit.

To further enhance the independent third-party financial auditing of the university, on February 7, 2020, upon the recommendation of the administration and after a four-month search, bid, and interview process by the Board of Trustees Finance Committee, the Board of Trustees selected a new third-party financial audit firm, CapinCrouse LLP, a preeminent national public accounting firm serving mission-focused nonprofit organizations. CapinCrouse has a team of auditor accountants who are higher education experts, experienced in industry best practices and dedicated to helping universities operate with financial integrity and success to achieve the mission of changing students' lives. Having an auditing firm of this caliber is wise given the complexity of the university's finances.

One goal of moving to a new auditing firm was to obtain a fresh examination of the university's financial reporting decisions. The new firm's three-month long audit examination concluded on September 4, 2020, with an unqualified opinion or clean audit. After a thorough review, the Finance Committee of the Board of Trustees recommended approval of the auditor's report by the entire Board, and the report was approved by the full Board on September 8, 2020.

Accounting Rule Changes. From time to time, the above-mentioned GAAP and FASB rules are changed. When FASB rules change, auditors frequently require clients to restate a prior year's financial statement so that it complies with the revised rule. During the CapinCrouse audit in the summer of 2020, an asset account was restated to adhere to a new FASB reporting format, which led to a restatement of the university's audited financial statements for Fiscal Year 2019. The term "restatement" is a broad one that refers to any number of required accounting changes.

The university's restatement for Fiscal Year 2019 occurred because of accounting rule changes pertaining to the categories for classifying and reporting donor restricted and board restricted assets and not because of dishonesty of any kind nor for any other reason except to adhere to the FASB rule changes.

A new financial statement reporting format from the Financial Accounting Standards Board (FASB) that became applicable for Fiscal Year 2019 more clearly required nonprofit organizations to separate assets on balance sheets between "with donor restrictions" and "without donor restrictions." During HSU's most recent financial audit, certain donor gifts and other assets originally recorded in 1964, 1987, 2004, 2005 and 2007 in a total amount of $11,119,034 were reclassed from "with donor restrictions" to "without donor restrictions." When the university received these assets in the respective years, these amounts were recorded on the balance sheets as having temporary usage restrictions, and the footnotes to the ensuing years' financial statements reported the assets as either "Designated by the board for endowment" or "Temporarily restricted endowment." Even though these assets were not donor restricted but only Board of Trustee restricted, they were reported as temporarily restricted under the old FASB format. To adhere to the new FASB format, they were reclassed to "without donor restrictions" or "unrestricted assets" in the audited financials for Fiscal Year 2019 (June 2018 – May 2019).

The reclassification of these six assets originally recorded between 1964-2007 did not result in any new or additional funds becoming available for university operations. The dollar valuation of these six assets was not changed by the reclassification, and the assets will continue to be used as quasi-endowment in accordance with Board of Trustees resolutions. No material change to the university's finances or financial condition necessitated the restatement nor resulted from the restatement; it was simply a reclassification of assets to adhere to a new reporting format.

Sale of Mineral Interests. During the summer of 2019, and totally unrelated to the restatement of the audited financial statements for FY2019, the Board of Trustees approved the sale of mineral interest holdings from the 2004 June Frost Leland estate gift which have always been maintained by the university as quasi-endowment funds. The fair market value of these minerals grew in 2018 and 2019 as the shale deposits in this mineral interest were developed for production. The university was approached by a group wanting to purchase some of the university's mineral holdings, and the administration enlisted the help of professionals to evaluate those interests. The offer was extremely generous, and, in August of 2019, the university sold the portion of the mineral interests beneath three sections of Loving County, Texas, for $48 million. The accounting of this sale was simply an exchange of the non-liquid mineral interest asset for the liquid asset cash. These funds were not a new gift or a new asset.

Hardin-Simmons was fortunate to sell these mineral rights before the subsequent oil crash. The $48 million transaction was voted on by the full Board of Trustees, which included several trustees who were knowledgeable of oil and gas prices at the time. The proceeds of the sale are now invested and will be used to help secure the long-term financial stability of the university. This sale of June Frost Leland gift mineral interests occurred in Fiscal Year 2020, and the sale proceeds were not included nor were in any way related to the accounting restatement of Fiscal Year 2019 (June 2018 - May 2019) which reclassed $11,119,034 of other assets.

Trustee Oversight. It is important to note that, when the decisions to close several programs were made during the last couple of years, the trustees were fully informed of a) the mineral interests holdings included in the quasi-endowment funds, b) the proceeds of sale of the mineral interests once the transaction occurred, and c) the overall financial condition of the university. Moreover, neither the restatement of the audited financial statements for Fiscal Year 2019 nor the corresponding reclassification of assets changes the underlying circumstances that resulted in prudent decisions concerning necessary program closures.

Included in the recent assessments and related actions is the decision to close multiple academic programs and majors, including closure of the Logsdon Seminary. Since its inception in 2004, the Logsdon Seminary has not generated the net operational revenue necessary to be financially sustainable without heavy reliance on financial resources from the university. The total restricted endowments designated for Logsdon Seminary amount to less than $1 million, and only appropriate distributions of approximately 5% of these endowments could be spent on the seminary. Even after taking donor gifts into account along with annual distributions from the endowment, the seminary's revenues never reached break-even, and this fact led to the decision to close the seminary.

Donors' gifts for Logsdon Seminary, including endowments designated specifically for the seminary, always have been and will continue to be used properly. The university has been responsive to all university donors' inquiries, and is actively reaching out to and working with donors whose gifts for the Logsdon Seminary will be affected by the closure of the seminary once the teach out period is completed. The university is committed to abiding by donor gift agreements and to respectfully working directly with each donor to reach appropriate resolution.

An important distinction to note is that the Logsdon School of Theology has been in existence since 1983 with adequate operating revenue and funding, including an endowment of approximately $32 million. The Logsdon School of Theology will continue to operate after the closure of the Logsdon Seminary, supporting Christian education for current and future students as part of fulfilling the HSU Mission.

Commitment to Financial Transparency. In order to help insure that HSU is transparent and in compliance with non-profit financial reporting requirements, its most three recent IRS Form 990s and most recent audited financial statements are available for viewing at www.guidestar.org. The Form 990 for the Fiscal Year ended May 31, 2020, is currently being prepared by independent accountants CapinCrouse LLP, and will be available on the GuideStar site after it is filed with the IRS. Similar to the time needed to prepare personal and business returns after the end of the Fiscal Year, there is no undue delay in the completion and filing of HSU’s 990s.

For information regarding the overall financial health and direction of the university, you may view a July 2020 presentation by members of our Board of Trustees at HSU Financial Presentation.

Hardin-Simmons University remains well-positioned for stability and sustained growth thanks to the support of the HSU family and because of the hard work and sound financial decisions during the last few years. With the fall semester well underway, the university is currently on track to adhere to the approved budget for the 2020-21 Fiscal Year without resorting to use of quasi-endowment funds and the overall financial condition of the university is improving. The trustees remain confident about the financial well-being and long-term viability of the university and will continue to fulfill their fiduciary obligations to position the administration, faculty, staff, and students to fulfill HSU's mission for decades to come.