# Department of Education
# Nova Scotia College of Art & Design
# Special Advisor – Final Report

**Special Advisor – Final Report**

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Report pursuant to Letter of Agreement between Department of Education, Province of Nova Scotia and Nova Scotia College of Art & Design

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# 1. Executive Overview

It is not an overstatement to say that the financial future and the future of NSCAD will be determined in the next 6 months.

Significant losses have been incurred since 2007. These losses are largely attributable to the lack of revenue to cover the costs related to new facilities at the Port Campus. Without the development of the Port Campus facilities NSCAD may well have not been able to continue the operations transferred to the Port due to the risks and costs of operating 100 year old facilities not designed or suited for their specialized activities.

The magnitude of the losses has depleted NSCAD's cash reserves. The College's borrowing capacity, on commercial terms, has likely been exhausted. Without a government cash advance in November of 2009, NSCAD could not have met its obligations.

Without intervention, the following course of events is entirely possible:

- Current cash flow projections show a negative bank balance by the summer of 2010;
- Without access to cash, NSCAD would not be able to meet its financial obligations. The Department has advanced $3.2 million to NSCAD. Even if a further advance was made in 2010, while enabling obligations to be paid, would not address the question of the College's financial viability;
- The financial statements for March 31, 2010 will show continued losses. The Operating and Capital Funds will both be in deficit position. Their combined deficits will exceed the positive balance in the Endowment Fund resulting in an overall net deficiency;
- As part of the audit of the March 31, 2010 financial statements, the auditors must assess the ability for NSCAD to be considered a "going concern". Should the auditors judge that the recent history of losses, continuing negative changes in cash flows, and impending negative bank balance with constrained ability to access loans, their opinion may include a caution that without outside assistance, NSCAD's ability to function as a going concern is in question;
- The College's current lenders may be concerned potentially limiting further advances or worst, calling of existing demand loans. Even if no action against NSCAD is taken, lenders will likely aggressively appeal to the Department and Government; and
- Depending on how widespread the knowledge of NSCAD's financial situation becomes, the ability to attract students will be seriously jeopardized.

## Summary of Advice

This report contains advice in the following areas:

1) Sustainability and stability of funding over the Medium Term

   a. The department should consider, in addition to converting the November 2009 advance to a grant, providing additional annual grants to NSCAD for 2009-10 and future years in the estimated amount of $1,400,000 reflecting changes in facilities costs since 2007 and the Department's past practice of funding space related costs.

   b. The November 2009 advance of $3.2 million should be recognized as a grant. A further grant of up to $1.4 million will be required by March 31, 2010.

   c. A comprehensive review of NSCAD's financial situation should be conducted at the end of the 2012-13 fiscal year.

2) Financial reporting for Financial Management purposes

   a. NSCAD should assess the use of the fund method of accounting to determine if it provides sufficient and easily understood information for the management and reporting of the College's finances. If the assessment determines that the fund method should continue to be used, the following measures should be taken:

      i. Ensure that capital contributions are allocated to revenue over the useful life of the asset for which the contribution was received;

      ii. NSCAD should consider allocating capital contributions to revenue only to the extent of the amount of amortization related to the asset for which the contribution was received

      iii. If interest on borrowings to finance major capital assets is to be charged to the Capital Fund, this policy should be applied on a consistent basis.

   b. The current monthly financial forecast format should be reclassified to show at least the following major categories of activities:

      i. Complete revenues and expenses of both the operating and capital funds with no cash only items included.

      ii. A separate section should add (or deduct as necessary) amortization and other accrual items; and

      iii. A final section should forecast the impact on the cash position and the College's ending cash position.

3) Debt consolidation

   a. In view of the studies underway on alternative facilities, loan consolidation should be deferred until the timing of any action on facilities is clearer.

## 2. Background

In September 2009, the Nova Scotia College of Art & Design (NSCAD) advised the Department of Education (Education) of its funding shortfall and associated, impending cash flow issues. NSCAD and Education agreed to work together to resolve the short and long term financial issues through a Letter of Agreement. Both parties agreed to engage a Special Advisor to report jointly to the President of NSCAD and the Deputy Minister of Education. The Agreement set out specific actions to be undertaken by the Special Advisor.

## 3. Reported Situation

NSCAD reported that their revenues were insufficient to cover expenses by approximately $1.2 million on an annual basis. In addition, NSCAD's cash resources would be exhausted in November, 2009 with an anticipated shortfall of $3,262,739 which could not be financed by working capital loans from their lender. In November, Education provided NSCAD with an early payment of $3.2 million from NSCAD's 2010-11 grant that would have otherwise been advanced in March 2010.

NSCAD's projections indicate that with the early payment received in November their cash flow difficulties will be alleviated for approximately a year, until October 2010. In October 2010, NSCAD projects its cash flow shortage will grow by about $700,000 to over $1,000,000 a month

## 4. Development of Current Situation

NSCAD uses the fund accounting method for managing and reporting its financial results and position. The fund accounting method is common among universities and can be useful for managing and reporting on the use of funds that may have been received with restrictions on their use.

However, this method of accounting combined with decisions on how certain items were allocated among the operating, fund, capital fund and balance sheet, impeded the ability of NSCAD and the Department to identify and quantify funding deficits and the growing cash shortfall on a proactive basis.

To better understand the financial situation and identify ways in which it could be more closely monitored in the future, I have reclassified NSCAD's financial reporting on a basis other than the fund accounting method. For purposes of identifying and quantifying NSCAD's funding and financing issues, the Endowment Fund is excluded from any further discussion.

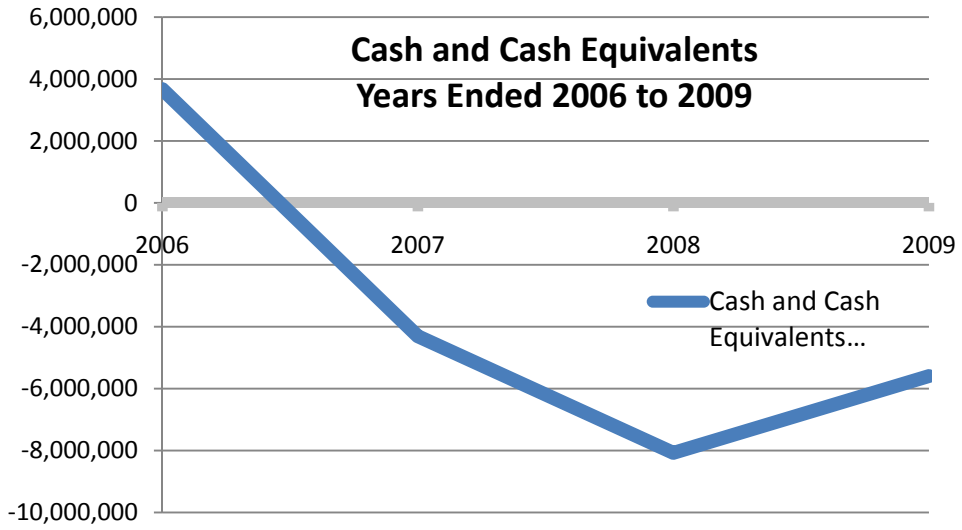
It appears that the major funding and cash flow difficulties arose in the last two fiscal years (2007/08 and 2008/09). This also coincides with the beginning of operations at the Port Campus and the servicing of the related debt. NSCAD's Statement of Operations for the past two years is summarized as follows:

**Summary of Statement of Operations**
**Combination of Operating and Capital Funds**

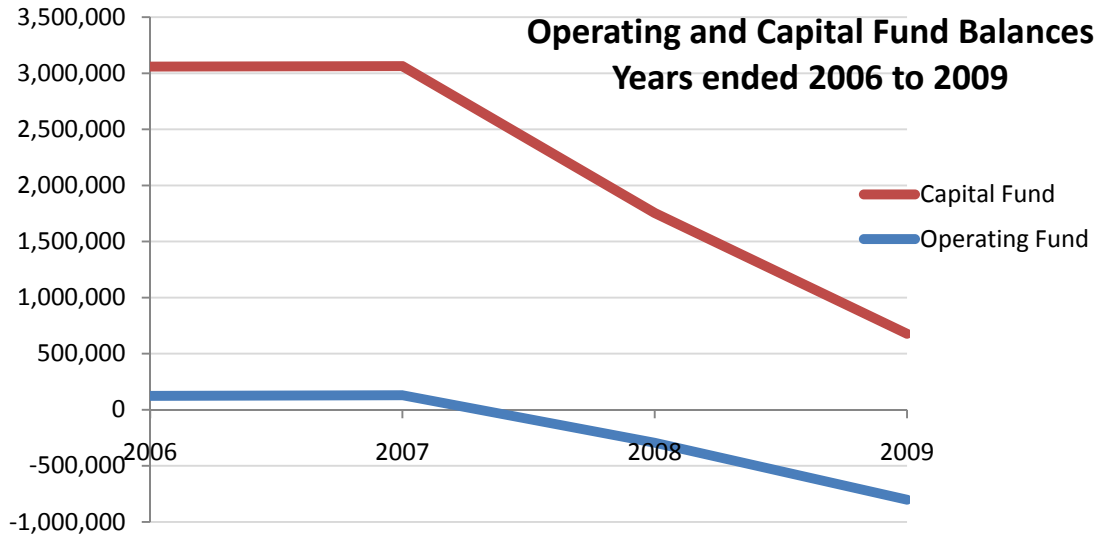
| | Year Ended March 31, 2009 | | | Year Ended March 31, 2008 | | |
|---|---|---|---|---|---|---|
| | Operating Fund | Capital Fund | Combined Funds | Operating Fund | Capital Fund | Combined Funds |
| Revenue | 16,128,325 | 2,041,887 | 18,170,212 | 14,794,795 | 1,420,005 | 16,214,800 |
| Expenses | 16,181,062 | 1,918,832 | 18,099,894 | 14,793,098 | 1,441,993 | 16,235,091 |
| Excess (Deficiency) | (52,737) | 123,055 | 70,318 | 1,697 | (21,988) | (20,291) |

An examination of the Statement of Operations in the financial statements for the last two years would not raise any particular alarm. Other items in the financial statements, if considered in relation to previous fiscal years, are cause for concern.

The Statement of Cash Flows, when examined over a four year period, shows the rapid decline in cash and cash equivalents. The apparent recovery in 2009 may be due to the Government's decision to provide universities with funding in advance of the 2009/10 fiscal year.



Similarly, an examination of the Operating and Capital Fund balances over the past four years, illustrates, from a different perspective, the deficiency of revenue and cash.




## 5. Financial Reporting

Contributions NSCAD received in connection with the construction of the Port Campus were recorded as deferred capital contributions. These contributions were meant to offset the capital costs of the Port Campus over the 40 year term of the lease at the Port site. In 2008 and 2009, certain costs (loan interest, fund raising, and amortization of assets in excess of the Port Campus amortization) were allocated to this deferred capital contribution account. At the rate that costs were being allocated to this account it would likely be depleted within three to four years.

In order to see a clearer picture of NSCAD's financial situation, I have prepared a schedule which allocates a portion of the amortization of the Port Campus in an amount that would result in the deferred contributions account being depleted coincident with the end of the lease of the Port Campus.

**Re-allocation of Port Campus Capital Contributions**
**Fiscal years Ended 2008 and 2009**

| | 2009 | 2008 |
|---|---|---|
| Revenue | $ 18,170,212 | $ 16,214,800 |
| Remove capital contributions allocated to Capital Fund | (1,619,436) | (1,199,504) |
| Allocate capital contributions to coincide with Port Campus lease term | 174,069 | 209,439 |
| Revenue – Combined Funds – After Re-allocation | 16,724,845 | 15,224,735 |
| Expenses | 18,099,894 | 16,235,091 |
| Deficiency of Revenue over Expenses – Combined Funds – After Re-allocation | $ (1,375,049) | $ (1,010,356) |

***Advice***

The manner in which NSCAD has used the fund method of accounting and financial policy decisions regarded recognition of capital contributions has obscured the revenue shortfall making it more difficult to quantify and monitor. Clearer reporting of operating results would likely have brought the College's funding and cash flow deficiencies to the attention of the Administration and the Department much sooner.

> Advice – *NSCAD should assess the use of the fund method of accounting to determine if it provides sufficient and easily understood information for the management and reporting of the College's finances. If the assessment determines that the fund method should continue to be used, the following measures should be taken:*
>
> - *Ensure that capital contributions are allocated to revenue over the useful life of the asset for which the contribution was received;*
> - *NSCAD should consider allocating capital contributions to revenue only to the extent of the amount of amortization related to the asset for which the contribution was received; and*
> - *If interest on borrowings to finance major capital assets is to be charged to the Capital Fund, this policy should be applied on a consistent basis. At present, interest on loans for the Granville Block and the Port Campus are recorded in both the Operating and Capital funds.*

After reviewing drafts of the revised presentation and allocation, the College has made changes to its internal reports to allocate capital contributions to coincide with the term of the Port Campus lease. They also intend to restate their financial statements from prior years to reflect the more realistic allocation. Further refinements will be made to monthly financial reports for the next fiscal year.

## Cash Flow Implications

The deficiency of revenue over expense is an accounting measure. The measure includes some accounting estimates and accruals that do not involve an inflow or outflow of cash. In order to illustrate, at a high level, how the deficiency has affect cash balances, adjustments are required for non cash items.

This estimate is not intended to be precise. Rather it is intended to demonstrate the depletion of cash from operations, how it has impacted the current situation, and the importance of effective financial reporting to monitor the situation in the future. While the following schedule will not agree entirely with the more complete financial statements, it is still relevant to understanding and improving NSCAD's financial situation.

This illustration focuses on operating items only. There are additional cash flows from changes in working capital items, new borrowings, capital asset acquisitions, and other items. However, the illustration demonstrates how the cash flow deficiency arose in the period of two years and how it will continue to grow without mitigation.

**Illustration of impact of operating deficiencies on cash position**
**Fiscal years ended 2008 and 2009**

| | 2009 | 2008 |
|---|---|---|
| Revenue – Combined Funds – After Re-allocation | $ 16,724,845 | $ 15,224,735 |
| Remove capital contribution allocation – non-cash item | (174,069) | (209,439) |
| Remove non-space grants (usage restricted to capital) | (422,450) | (422,451) |
| Revenue – after adjustment for major non-cash items | 16,128,326 | 14,592,845 |
| Expenses | 18,099,894 | 16,235,091 |
| Remove amortization – non-cash item | (864,500) | (725,541) |
| Expense – after adjustment for major non-cash item | 17,235,394 | 15,509,550 |
| | (1,107,068) | (916,705) |
| Other cash items: | | |
| Principal payments on debt | 679,512 | 468,907 |
| Impact from major items on cash from operations | (1,786,580) | (1,385,612) |

## *Advice*

*NSCAD should consider expanding its monthly financial monitoring statements to include reporting on how cash is impacted by the Operating and Capital funds, the current cash balances, and how future cash balances will be impacted by operating results.*

## Major Impacts on College's Finances

In order to understand the factors contributing to the growth in annual deficits, the fiscal years 2007 and 2009 were compared. 2007 was selected as a base for discussion purposes because deficits increased significantly from that point and it was just prior to the start of operations at the Port Campus.

The comparison is made on the basis of combining the operating and capital funds. The amounts used for 2009 reflect the re-allocation of capital contributions as discussed earlier. For clarity, only the major variances are shown.

In addition to the almost $1.2 million increase in the net annual deficit, additional pressure was put on cash flow in order to provide payments of principal on new financing for the Port Campus. In 2007 principal payments were $399,000. Two years later in 2009, principal payments were $679,512, an increase of more than $280,000.

**Major Variances**
**2009 fiscal year compared to 2007**

| | 2009 | 2007 | Variance | % | Note |
|---|---|---|---|---|---|
| **Revenue** | | | | | |
| Unrestricted PNS grants | $ 7,398,135 | $ 5,141,007 | $ 2,257,128 | 43.9 | 1 |
| All other accounts | 9,326,710 | 9,342,947 | -16,237 | -0.2 | |
| Total revenue | 16,724,845 | 14,483,954 | 2,240,891 | 15.5 | |
| **Expenses** | | | | | |
| Academic - Salaries | 7,597,575 | 6,596,775 | 1,000,800 | 15.2 | 2 |
| Administration | 2,441,466 | 1,819,169 | 622,297 | 34.2 | 3 |
| Amortization | 864,500 | 461,719 | 402,781 | 87.2 | 4 |
| Interest | 1,147,323 | 717,546 | 429,777 | 59.9 | 5 |
| Physical plant | 2,366,886 | 1,610,076 | 756,810 | 47.0 | 6 |
| All other accounts | 3,682,144 | 3,466,626 | 215,518 | 6.2 | |
| Total expense | 18,099,894 | 14,671,911 | 3,427,983 | 23.4 | |
| Deficiency of revenue over expense – combined funds | $ (1,375,049) | $ (187,957) | $ (1,187,092) | | |

1. All growth in revenue over the two years is due to increases in provincial unrestricted grants. The next largest source of revenue, Student Fees, declined by 2%.

2. Academic salaries accounted for the largest dollar growth in expenses.

3. A portion of the growth in Administration is due to the expansion of the Advancement Office to University Relations to manage, in addition to other functions, the capital campaign.

4. The increase in amortization is to be expected. The increase reflects the amortization of leasehold improvements at the Port Campus.

5. Interest expense increased due to borrowings to finance expansion to the Port Campus.

6. Increases in Physical Plant reflect primarily the increased operating costs of the Port Campus.

**Advice**

Since 2007, the deficiency of revenue has increased by $1.2 million. The increase is due to a number of factors.

- Revenue growth is flat, other than government funding. This reflects, in part, the understanding universities have with the Province that tuition and fees would not be increased during the term of the MOU. While government grants have increased significantly, the College is limited to increasing enrollment in order to generate revenue. While the College has continued to attract students, additional costs may be incurred depending on the areas in which enrollment increases.

- Academic salaries and benefits have increased significantly from 2007 to 2009. This area has received and will continue to require intensive examination on ways to be economical and efficient. The examination should focus on a combination of complement numbers, class assignments, wage rates, and benefit costs.

- Increases in Administration costs appear to be, in part, the result of enhancing the College's public and donor relations programs. These functions are necessary at most any university but must be continually assessed for cost effectiveness.

- The cost increases related to fixed assets and facilities reflect NSCAD's very challenging situation where 72% of its square footage is in structures that are more than 100 years old and, although renovated, were not designed for the College's purposes.

## 6. Financial Management

**2009-10 Fiscal Year**

NSCAD prepares regular and comprehensive financial reports on a regular basis to monitor the forecast financial position compared to the budget. These reports are provided to the Finance and Property Committee.

The budget for the current fiscal year projects a surplus of $110,000. The budget for the previous fiscal year (2008-09) projected a surplus of more than $52,000.

While the budget monitoring process appears to be systematic, timely, and disciplined the projected annual results will not be predictive of the actual results because:

- The budget covers the Operating Fund only;
- Interest on the Port Campus loans is not included;
- Amortization is not included; and
- The budget contains a mixture of cash and accrual items.

The College's ability to produce financial reports efficiently and in other than standard formats is constrained by the accounting system. The new Vice-President, Finance and Administration has made arrangements to install a more functional system which will eventually provide for reports designed to meet the College's needs.

The current budget monitoring system allows the College to closely monitor the majority of its revenue and cost items. However, because the budget does not include all costs and includes some cash items, which are not expenses, NSCAD will not be able to easily assess its overall financial position or anticipate what the financial statements, when published, will disclose.

The College's internal financial forecast as at December 31, 2009 has been reclassified to reallocate cash items and include expenses and other items not included:

**NSCAD**
**Financial Forecast Management Report**
**Year Ending March 31, 2010**

| | |
|---|---|
| **Revenue** | **17,261,838** |
| **Expense** | **17,392,550** |
| **(Deficit) before amortization** | **(130,712)** |
| **Amortization** | **690,970** |
| **(Deficit) for the period** | **(821,682)** |
| **Cash items:** | |
| (Deficit) before amortization | (130,712) |
| Principal payments | 994,220 |
| Non-space/ A&R | 230,000 |
| **Impact on cash position from operations** | **$ (1,354,932)** |

**Advice**

*The specific format of the monthly financial forecasts should be prepared in a manner that is understandable to the Administration and the Board. The current financial forecast format should be reclassified to show at least the following major categories of activities:*

- *Complete revenues and expenses of both the operating and capital funds with no cash only items included. The difference between revenue and expense should be described as results before accrual items (or specify which accrual items are not included e.g. amortization);*

- *A separate section should add (or deduct as necessary) amortization and other accrual items. The difference between revenues and expenses in this section is the best forecast of the results that will be presented in the year-end financial statements; and*

- *A final section should forecast the impact on the cash position and the College's ending cash position. Examples of items included in this section include results of operations before accrual items, principal payments on debt, and the acquisition cost of assets that are purchased from grants provided for the specific purpose of capital assets (e.g. Non-space grants, etc).*

**2010-11 Fiscal Year**

The College is in the midst of their budget process for the 2010-11 fiscal year. As with most budget processes, funding requirements are estimated using various assumptions. Once the initial estimates are made and compared to expected revenues, areas where the estimated expenses can be reduced are examined.

The assumptions and budget process the College is following appears reasonable and thorough. At this early stage, recognizing that the difficult decisions about expense reduction have not been made, the estimated financial outlook is as follows:

**Initial Budget Estimate**
**Year Ending March 31, 2011**

| | |
|---|---|
| **Revenue** | **17,280,000** |
| **Expense** | **17,733,000** |
| **(Deficit) before amortization** | **(453,000)** |
| | |
| **Amortization** | **690,970** |
| | |
| **(Deficit) for the period** | **(1,143,970)** |
| | |
| **Cash items:** | |
| (Deficit) before amortization | (453,000) |
| Granville principal | 521,000 |
| Port principal | 305,000 |
| Non-space/ A&R | 242,000 |
| **Impact on cash position from operations** | **$(1,527,000)** |

I have reviewed the assumptions and estimates used in developing the initial budget deficit estimate of $ 453,000. In general, they are reasonable and there are limited areas for additional savings of any magnitude. The budget contains a one time cost of $50,000 to cover training in a new student information and financial system. The only area where economies might be achieved is the 2% general inflationary increase that was allowed for all departments. A further $50,000 in savings would be a rough estimate of the maximum achievable.

From my observations and review of the budget, it is fair to say that NSCAD is bring operated in an economical manner. The increase in academic salaries and benefits appears higher than I would have expected in the public sector but I have been advised that it is in the range of increases of other universities.

## 7. Cumulative Impacts on Cash Position

The following schedule shows the cumulative impacts on cash from operations to March 31, 2009, forecast to 2010, and projected to the end of the next budget year, March 31, 2011. The amounts are taken from the previous schedules in this report.

**Cumulative Impacts on Cash Position**
**Fiscal Years ended 2007 to 2009, 2010 forecast, and 2011preliminary budget estimate**

| Fiscal Year | Impact on Cash Position from Operations |
|---|---|
| 2007 - Actual | $ 188,000 |
| 2008 - Actual | 1,385,600 |
| 2009 - Actual | 1,786,600 |
| | 3,360,200 |
| 2010 - Forecast | 1,355,000 |
| | 4,715,200 |
| 2011 - Preliminary budget estimate | 1,527,000 |
| | $6,242,200 |

In November 2009, the Department of Education provided an advance payment to NSCAD of $3.2 million based on cash flow schedules provided by the College. The previous analysis shows that the negative impacts on the Colleges cash position likely began in 2007, accelerated dramatically in 2008 and 2009, and cash flows will continue to be significantly negative for the current and future fiscal years.

The November cash advance allowed NSCAD to remain solvent. However, there are no obvious prospects for NSCAD to repay the advance or any further advances in the future.

Beginning with the 2008 fiscal year, annual losses were incurred in the range of $1.2 million. Additional cash was required for repayment of the principal portion of the Port Campus debt. While most of the increased costs causing the operational losses appear related to the Colleges facilities and the Port Campus, academic salaries have increased by more than 15% in two years.

**Advice**

*The Department of Education should consider, within its legislative and budgetary means, providing grants to NSCAD to cover the current cash deficit and prevent future cash shortfalls, in the following manner:*

- *The November 2009 advance of $3.2 million should be recognized as a grant;*
- *A further grant of up to $1.4 million will be required by March 31, 2010;*
- *The 2010-11 budget is in its preliminary stage. It would not be prudent to approve additional funding until all cost containment measures have been exhausted. In addition, there may be measures that can be taken as the year progresses for further efficiencies and cost savings.*

  *However, given the College's slim cash margins funding a portion of the estimated 2010-11 shortfall is necessary. A suggested approach that provides funding but allows the Department to assess the progress NSCAD makes achieving cost efficiencies is as follows:*

  - *Provide $1million in additional funding for the 2010-11 fiscal year in the normal manner in which the grants would be provided;*
  - *NSCAD provide a report, based on the seven months ending October 31, 2010, detailing:*
    - *Its approved budget and year to date results;*
    - *Projected financial results to March 31, 2011;*
    - *Explanation of variances of projected results from the approves budget;*
    - *Cash flow projections to March 31, 2012; and*
    - *Any other items that the Departments believes essential to assessing the College's current and projected financial position.*
  - *Based on the Department's review of the report provide remaining funding to an amount they believe reasonable and warranted.*
  - *The payment of Assistance to Universities for the 2010-11 fiscal year is not being made in the normal pattern due to Government's decision to pay the assistance by March 2010. The anticipated cash shortfall for 2010-11 may have to be mitigated by March 31, 2010 if the Department wants to include all assistance for 2010-11 in the 2009-10 fiscal year.*

All of the schedules and discussion in this report have been predicated on the status quo operations and reaching an evenly balanced budget. The College believes that while addressing their financial situation is vital, funding for additional programming is necessary if the College is to be able to retain and increase its enrolment. No allowance has been made for new programs and services that the College has examined and would like to implement.

## 8. Advice for Medium Term Sustainability and Stability

The Department has had a long standing practice and history of funding NSCAD's property and space costs. For many years the cost of leased premises (Morse's Tea building, Granville Block) was paid by the Province. When NSCAD's space was consolidated and title obtained for the Granville Block, the funding for lease costs was continued but, directed to maintenance costs and loan payments.

While other costs have contributed to NSCAD's recent string of annual deficits, the move of some operations to the Port Campus and the Academy Building created new, incremental significant costs for which there was no new funding. The financing and operating costs of these additional facilities are the main causes of the recent operating and cash flow deficits.

If the actual costs of the Port Campus and Academy Building had been known or projected, the operating losses and cash flow deficits could have been planned for. However, earlier determination of the impact of these costs on NSCAD's financial position was made difficult because the amount of these costs was underestimated, the financial reporting method and financial policy decisions and the Government's decision to make advance payment of university grants delayed the full picture from coming into view.

An approach to providing stability to NSCAD's financial position is set out in the following table:

**Approach to providing Sustainability and Stability**

| | 2010-11 Budget | 2009-10 Forecast | 2008-09 Actual | 2007-08 Actual |
|---|---|---|---|---|
| Port Campus operating costs | 915,982 | 889,122 | 886,000 | 513,087 |
| Port Campus - Interest | 474,317 | 279,000 | 474,000 | 444,000 |
| Academy Building – Operating costs | 199,000 | 188,000 | 182,000 | 150,000 |
| Total | 1,589,299 | 1,356,122 | 1,542,000 | 1,107,087 |
| 4 Year average $ 1,398,627 | | | | |
| Deficit – Combined Funds (1) | <1,143,970> | <821,682> | <1,375,049> | <1,010,356> |
| Assumed additional grant for new space | 1,400,000 | 1,400,000 | 1,400,000 | 1,400,000 |
| Surplus – Combined Funds (1) | 256,030 | 578,318 | 24,951 | 389,644 |
| Cash Flow impact from operations | <1,527,000> | <1,354,932> | <1,786,580> | <1,385,612> |
| Assume additional grant for new space | 1,400,000 | 1,400,000 | 1,400,000 | 1,400,000 |
| Revised Cash Flow Impact | <127,000> | 45,068 | <386,580> | 14,388 |

(1) Excludes accrual items such as changes in market value of financial instruments

On average, over the past four years, costs related to new facilities amounted to $ 1,400,000 per year. If the Department's practice of funding space costs had been maintained, it is likely that at least a portion of these costs would have been funded or, if all costs were known with certainty, the new space would not have been entered into with the resulting programming difficulties.

If the average space costs had been and were to be funded in the future, it would have the following effects:

- The annual results of the combined Operating and Capital Funds would likely be surpluses. The analysis does not include estimates for the accrual of changes in fair market value of financial instruments, a non cash item. For the year ended March 31, 2009, Fund balances were reduced for the change in fair value of cash flow hedge ($ 1,147,396) and unrealized trading losses ($ 2,322) ;

- There is a risk that the combined fund surpluses, exclusive of financial instrument accrual items, would encourage spending that is not supportable from a cash flow perspective;

- There would continue to be a negative impact on the College's cash position from operations from time to time but, significantly reduced. Over time, the negative impacts would be smoothed and financed in the short term by the College's line of credit;

- Interest on the Port Campus financing would reduce as the loan balance was reduced. Operating costs would be expected to increase reflecting increased power, fuel and other maintenance expenses; and

- No specific allowance has been made for the cash required for repayment of principal portion of the Port Campus financing. If the full amount of the annual principal repayment was recognized in additional funding there would be a surplus cash flow position each year and a significantly greater surplus on an accounting basis.

## Advice

It is not an overstatement to say that the financial future and the future of NSCAD will be determined in the next 6 months.

Significant losses have been incurred since 2007. These losses are largely attributable to the lack of revenue to cover the costs related to new facilities at the Port Campus. The magnitude of the losses has depleted NSCAD's cash reserves. The College's borrowing capacity, on commercial terms, has likely been exhausted. Without a government cash advance in November of 2009, NSCAD could not have met its obligations and is projected to be in a similar negative cash position by November 2010.

The analysis in this report has been conducted at a macro level. Detailed cash flow statements were provided in September 2009 but require updating. The analysis confirms the direction and magnitude of cash flows consistent with the September projections. In addition, NSCAD's monthly financial reporting documents are evolving and improving but require consistency and more experience with the revised format. In view of these items and for adequate

accountability, my advice is for special reports to Education mid way through the 2010-11 fiscal year and a comprehensive review of their situation at the end of the 2012-13 fiscal year.

*To provide stability and sustainability to NSCAD in the medium term, I provide the following advice:*

- *The department should consider, in addition to converting the November 2009 advance to a grant, providing additional annual grants to NSCAD for 2009-10 and future years in the estimated amount of $1,400,000 reflecting changes in facilities costs since 2007 and the Department's past practice of funding space related costs.*

- *The estimated additional funding of $1.4 million for 2010-11 may require adjustment depending on the Department's review of the College's financial position as advised in Section 7 of this report.*

- *NSCAD should provide its annual budget to the Department demonstrating that any surpluses anticipated have not been directed to programs that will have detrimental impact on their cash position such that cash deficits will be incurred on a long term basis.*

- *A comprehensive review of NSCAD's financial situation should be conducted at the end of the 2012-13 fiscal year.*

## 9. Prospects for Long Term Sustainability and Stability

The key issues for the longer term sustainability and stability of NSCAD could be categorized in three areas:

- Addressing the annual deficit and cash flow shortfall - The discussion and advice provided in this report flow from the September Letter of Agreement between NSCAD and the Department which is directed at the College's medium term funding and cash flow issues. Obviously these issues are essential to stabilizing the College's finances so its future can be planned rather than imposed by external factors.

- Review of funding rationale for academic programs – The advice in this report recognizes the Department's long standing practice of funding the cost of NSCAD's facilities. In the longer term, the College's finances could be at risk because of insufficient funding of its academic programs. NSCAD is different from most other universities in Nova Scotia because of its small enrolment and unique programming. Funding is greatly influenced by enrolment but it is not realistic to expect large increases in the number of students.

- Inappropriate type and location of facilities – As a result of a series of decisions and opportunities, NSCAD's operations have moved from old buildings within meters of each other (Granville Block, Morse's Tea and Lismore buildings) to a purpose built, leased facility at the Port, and a heritage building on Brunswick Street, which are approximately a kilometer from the remaining operations at the Granville Block. While some obvious

risks have been abated by purpose built facilities at the Port Campus, NSCAD has the added complication and costs of a dispersed campus and the majority of its facilities are in circa 1900 buildings with all the attendant risks and inefficiencies.

There may be a tendency to look to addressing NSCAD's cash and funding issues by liquidating some of its facilities or realizing the equity through loans from the Province. In my view, such actions would only provide short term relief and create future problems summarized below:

- NSCAD requires the physical space in order to deliver its programs.
- The Province would likely be reluctant to take on the redevelopment responsibilities that come with ownership of downtown properties.
- Any financial benefit generated from asset sales or loans against future sales would be temporary at best without a longer term facilities plan and a revenue stream capable of retiring the associated debt.
- At best, the NSCAD's funding and cash flow issues would be deferred to some future time period but operating losses would continue to accrue, and there would be no apparent method for the settlement of any funds advanced.
- NSCAD's equity in its property will be an essential part of financing new facilities to avoid the risks of the current older buildings and to provide proper space for the College's operations.

## 10. Building Appraisals

Under the terms of the Letter of Agreement between NSCAD and the Department, appraisals were to be conducted on the Academy Building and Granville Block by December 15, 2009. On December 18, NSCAD received the results of an "Opinion of Value" from CB Richard Ellis Ltd. The work appears comprehensive and values the properties under a number of different scenarios.

Alex Doyle, Director, Facilities Management at NSCAD is to be recognized for arranging for the work to be carried out in a timely and cost efficient manner.

Of particular note in the Opinion of Value was the following:

> *In 2002, NSCAD granted the Armour Group a Right of First Refusal in any sale transaction of the Granville Campus. The Right of First Refusal stipulates that any offer to purchase the Property must be submitted to Armour Group who, at their option, may accept the price, deposit, terms and conditions of the offer. Armour Group has 30 days from receipt of the offer to review and, if Armour chooses NSCAD must then accept an equal offer from Armour immediately.*
>
> *This will adversely impact any sale process of the Granville Campus. It would be our recommendation to explore any methods to remove this prior to a marketing campaign.*

## 11. Strategic Assessment and Facility Feasibility Study

The firm of Grant Thornton has undertaken the Study. The Study is progressing well with active participation by all members of the Steering Committee. The Study is close to completion, with one or two final meetings anticipated. A final report is likely by mid February.

As part of my participation on the Steering Committee, I was taken through an extensive tour of all three facilities. The current space appears to be fully utilized. As part of the planning for new facilities, it is estimated that additional square footage may be required. While the current space appears fully utilized, the actual amount of space required is difficult to determine because of:

- the configuration of the interior of the Granville Block and the Academy Building,
- the space was not originally built to suit NSCAD's needs and alteration is difficult and expensive, and
- changing fire safety and other codes have required alterations that may have been more space efficient if part of the original design.

A detailed space requirements study will be part of the planning process for future facilities.

## 12. Debt Structure

At December 31, 2009, NSCAD debt obligations were:

**Debt Obligations**
**As at December 31, 2009**

| Purpose | Rate | Amortization | Term | Amount |
|---|---|---|---|---|
| Advance on 2010-11 PNS grant | | | | $ 3,200,000 |
| Granville Block | Prime less 0.25% | 20 yrs | 10 yrs | $ 9,771,000 |
| Port Campus | Prime plus 0.25% | 20 yrs | 5 yrs | $ 9,749,998 |
| Operating line of credit - $ 750,000 limit | | | | $ 0 |

The financing is provided by the Bank of Nova Scotia. The loans are not mortgages but their long term and how they are administrated make them similar. Many other universities are in the same position due to the uniqueness of the loan collateral. The instructional nature of universities property does not make them attractive to lenders as security. Therefore the loans are essentially demand loans.

In the case of the Granville Block, the security is the February 2002 letter to the Bank from Education assuring a stream of payments to NSCAD for repayment of the loan. The last renewal of the lending arrangements included the following commitment regarding loans for the Port Campus:

> *In addition to scheduled monthly payments, any capital campaign donations relative to the Pier 24 Campus facility, net of campaign costs, are to be applied towards permanent reduction of the balance of the loan.*

The interest rates are floating but interest rate swaps are in place so the rate is essentially fixed. This also appears to be common among loans to universities.

The financial statements describe the loans as callable on demand.

**Advice**

*Given the nature of university assets and NSCAD's financial situation, it is unlikely that the terms of their borrowing with the current lender could be improved. Funding from alternate lenders, until their financial situation improves, would be difficult to secure.*

*The most viable arrangement would be consolidation of the borrowings with funds loaned from the Province with extended amortization periods. In view of the studies underway on alternative facilities, this loan consolidation should be deferred until the timing of any action on facilities is clearer.*

## 13. Letter of Agreement

On October 14, 2009, the Department and the College entered into a Letter of Agreement requiring a Special Advisor to carry out certain actions. This report covers the majority of the actions itemized in the Letter of Agreement. The actions anticipated that the Special Advisor would provide advice on NSCAD's preparation of a five year Business Plan. Given the significant financial challenges outlined in this report and the issues related to the College's facilities, the parties would be wise to consider the October Letter of Agreement concluded. If acceptable to both parties, a separate Letter of Agreement directed at financial and facilities issues would be worthwhile.

**Advice**

The Department and the College should consider the October 2009 Letter of Agreement concluded. A new Letter of Agreement directed at financial and facilities issues should be considered.