2018 ANNUAL FINANCIAL REPORT (Fiscal Year 2016-17)

SUMMARY

As required by the United States Department of Education the ACCJC conducts an annual fiscal health assessment of institutions within its purview.

Those assessments are based on twelve criteria in the **Composite Financial Index (CFI)**. The CFI's twelve factors are based on the analytic methodology outlined in *Strategic Financial Analysis for Higher Education*, 7th Edition, by the accounting firm of KPMG in association with NACUBO (National Association of College and University Business Officials). The CFI also takes into account factors from the Sound Financial Management Assessment Checklist used by the California Community Colleges Chancellor's Office, and other resources on financial analysis in higher education.

The ACCJC uses the CFI to numerically summarize the risk factors which have potentially negative consequences for the financial-health of an institution. Therefore, the greater the calculated score for a college the more risk the ACCJC finds in the data. Based on the relative numerical scores, each college is then categorized as **R** (referred for further analysis), **M** (subject to enhanced fiscal monitoring) or **N** (subject to normal monitoring). The twelve factors used to calculate the CFI are:

- Primary Reserve Ratio [(Beginning Balance + Revenue – Expenditures)/Expenditures]
- Net Operating Revenue Ratio [Income(Deficit)/Operating Revenue]
- Average Operating Deficit, over three years
- Average ratio of Salaries and Benefits to total Operating Expenditures, over three years
- Enrollment change
- Contributions to the Annual Required Contribution (ARC) for Other Post-Employment Benefits (OPEB)
- Changes in Cash Balance
- Audit concerns
- Federal Financial Student Loan Default Rates
- Cash Flow
- Contract settlements relative to the Cost Of Living Allowance (COLA)
- Turnover in executive level leadership

It is important to note that three of the twelve factors which make up the CFI are significantly more heavily weighted than the others. Those three factors which determine the greatest portions of a college's score are:

- Primary Reserve Ratio – 21% of the total possible CFI score
- Net Operating Revenue Ratio – 25% of the total possible CFI score
- Federal Financial Student Loan Default Rates – 20% of the total possible CFI score.

It is also important to realize that those three dominant factors impact different types of ACCJC institutions in very different ways. For example:

- Institutions such as the Hawai'i community colleges or the Los Angeles College of Nursing that are within a university or governmental umbrella do not have their own reserves or beginning and ending balances which are the critical factors in the two heaviest weighted criteria
- The financial strength as determined by the Primary Reserve Ratio and the Net Operating Ratio only are relevant to the districts within the California community college system, not the colleges that are within multi-college districts, so neither of the two heaviest weighted criteria apply to those colleges, just to the parent district
- For-profit institutions such as Carrington that are within a parent corporation do not have their own beginning or ending balances, so neither of the two heaviest weighted criteria apply to those colleges, just to the parent corporation that has retained earning, but not "fund balances"
- The third heaviest weighted factor, the federal student loan default rate, really only applies to an institution that is approaching the 30% threshold for federal penalties; below 30% there is not a direct negative impact on an institution related to federal loan defaults.

Thus, after the complete CFI is calculated for each college it is necessary to adjust the score for several types of colleges in order to reflect their special characteristics.

Results:

Based on the CFI results findings for all colleges that submitted their 2018 Annual Fiscal Reports to date the ACCJC's findings for the 2018 (2016-17 Fiscal Year) are the following:

- N: 82 Colleges - Fiscally healthy, no follow-up recommended
- M: 42 Colleges - Subject to enhanced fiscal monitoring
- R: 9 Colleges - Refer to the Fiscal Advisory Committee for further follow-up

Observations:

Of the nine colleges that are recommended for referral to the Fiscal Advisory Committee 4 are in one district. This is due primarily to the fact that the two heaviest weighted criteria are based on data points collected at the district-level, rather than at the college-level.

At least half of the 41 colleges that are categorized as "subject to enhanced fiscal monitoring" (M), score within that range because of their districts' ending balances and the importance of the ending balance in Criterion #1, the Primary Reserve Ratio. Although all the "M" colleges that are subject to Fund Accounting have ending fund balances in excess of 5%, a mere 5% ending balance is only enough to cover less than a month's worth of expenditures and so the Criterion #1 assigns up to five points a year for three years unless the ending balance is over 25%, which is still only enough to cover three months of expenses. Every college in the **N** and **M** categories had some level of declining enrollment over the three-year reporting period.

The Next Steps:

The ACCJC board will be asked to approve referring the "R" colleges to the Fiscal Advisory Committee for further review and follow-up. In addition to being asked to review the "R" colleges the committee will also be asked to work with the ACCJC's fiscal consultant to address issues with the current fiscal

evaluation process and the CFI, and to develop a recommendation concerning the 2019 (2018-19) ACCJC fiscal review.

At the January 2019 ACCJC board meeting ACCJC staff will report back to the board on the results of the follow-ups with the “R” colleges and will recommend what, if any, action the board should take. Staff also expects to present recommendations for modifying the annual review process and possibly adding a more informal heads-up interim fiscal health evaluation.