5/14/18

The ACCJC conducts annual monitoring of the financial conditions of colleges in accordance with federal requirements. The ACCJC uses data from the Annual Financial Report (AFR) and the Annual External Audit to calculate a score using The Composite Financial Index (CFI) for each college.

With the CFI, the ACCJC numerically represents the financial health of those colleges for which it is responsible to accredit. The index is composed of factors which are derived from the *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 *Sound Financial Management Assessment Checklist* of the California Community Colleges Chancellor's Office, and other resources on financial analysis in higher education.

The *Composite Financial Index* (CFI) is based on a set of factors that identify potential financial risks. As a result of a college's CFI calculation, it is categorized as **R** (referred for further analysis), **M** (subject to enhanced fiscal monitoring) or **N** (subject to normal monitoring).

This document describes the twelve factors used to calculate the CFI as they relate to the Annual Fiscal Report's questionnaire and resulting report. To best understand the CFI calculation this narrative should be read in conjunction with the CFI flowchart document and the printout of the Annual Fiscal Report questionnaire.

James Austin
Fiscal Consultant
ACCJC

**Unless otherwise noted all values are for the General Fund.*

- $Surplus(Deficit) = Total\ Revenues - Total\ Expenditures$
- **Criterion 1: Primary Reserve Ratio**

  The Primary Reserve Ratio measures the financial strength of the institution by comparing expendable net assets to total expenses. Expendable net assets represent those assets that the institution can access relatively quickly and spend to satisfy its debt obligations. This ratio provides a snapshot of financial strength and flexibility by indicating how long the institution could function using its expendable reserves without relying on additional net assets generated by operations.

  EXAMPLE:

  A 30% Primary Reserve Ratio indicates that the institution could remain solvent for 3.6 months (30% *12months). A three-year trend analysis indicates whether an institution has increased its net worth in proportion to the rate of growth in its operating size.

$$\left.\frac{Beginning\ Balance + Surplus(Deficit)}{Total\ Expenditure}\right\}\ for\ 3\ fiscal\ years$$

$$\boldsymbol{AFR\ Data\ Entry\ Form}: \frac{5 + 4a - 6a}{6a}$$

Score Range	% of Potential Total
$\mathbf{[0 - 15]}$	20.83%

- **Criterion 2: Net Operating Revenue Ratio**

  This ratio is a primary indicator, explaining how the surplus from operating activities affects the behavior of the other core ratios including the Primary Reserve Ratio. A large surplus or deficit directly impacts the amount of funds an institution adds to or subtracts from net assets, as well as the adequacy of funding for the delivery of services.

$$\left.\frac{Surplus(Deficit)}{Total\ Revenues}\right\}for\ 3\ fiscal\ years$$

$$\boldsymbol{AFR\ Data\ Entry\ Form}: \frac{4a - 6a}{4a}$$

Score Range	% of Potential Total
$\mathbf{[0 - 18]}$	25.00%

- **Criterion 3: Surplus (Deficit)**

This factor simply compares Total Expenses to Total Revenue over a three-year period. If expenses exceed revenues the reserves for uncertainty, fund balance or retained earnings for the institution will decrease unless other sources of revenue are found or if expenses are reduced to be less than the revenue.

$$Surplus(Deficit)\}, \textit{take the average over 3 years}$$

$$\boldsymbol{AFR\ Data\ Entry\ Form}: \frac{FY1:(4a-6a)+FY2:(4a-6a)+FY3:(4a-6a)}{3}$$

Score Range	% of Potential Total
$[\mathbf{0-2}]$	2.78%

- **Criterion 4: Salaries & Benefits as a Percent of Total Expenditures**

This calculation of the proportion of the average expenditures that were spent on total compensation costs over 3 years, indicates how much of the available resources are available for non-compensation requirements of the institution.

$$\left.\frac{Salaries\ \&\ Benefits}{Total\ Expenditures}\right\}, \textit{average over 3 years}$$

$$\boldsymbol{AFR\ Data\ Entry\ Form}: \frac{6b}{6a}$$

Score Range	% of Potential Total
$[\mathbf{0-2}]$	2.78%

- **Criterion 5: Change in Enrollment**

This criterion calculates the change in enrollment over the most recent three years. Although the instructions specify FTES (Full-Time equivalent Students) it is more appropriate for some ACCJC institutions to use head count or chair count. The type of metric counted is not as important as is the three-year trend. The enrollment trend is important to consider because for almost every institution in some way enrollments drive revenues and expenses. Especially in a case where enrollments are declining but expenses are increasing a deeper look into the institution's long-term viability is appropriate.

$$\Delta\ \textit{in actual FTES from year 1 to year 3}$$

$$\boldsymbol{AFR\ Data\ Entry\ Form}: \frac{FY3:18b-FY1:18b}{FY1:18b}$$

Score Range	% of Potential Total

$[\mathbf{0}-\mathbf{3}]$	4.17%

- **Criterion 6: Funded Ratio (of OPEB, Other Post Retirement Benefits)**

The Funded Ratio looks at the actuarial Value of the assets in an irrevocable trust compared to the estimated actuarial liability resulting from the OPEB plan. The consideration of the OPEB funding is driven by various GASB (Government Accounting and Standards Board) requirements (especially 45 and 75) to disclose to the public and financial communities the potential future costs of OPEB plans and the institution's level of irrevocable assets to address those future costs. In other words, GASB essential considers pension liabilities to be the same as long-term debt, and, therefore, the OPEB liability and funding must be a factor in evaluating the financial health of an institution. Due to the recent GASB bulletin 75 on this subject the actual calculation will be changing. For example, the AAL is now the TOL (Total OPEB Liability) and the UAAL is now the NOL (Net OPEB Liability). The diversity of institutions accredited by ACCJC adds to the complexity of this factor.

$$\boldsymbol{Current\ Formula}: \frac{Actuarial\ Value\ of\ the\ Plan\ Assets}{Actual\ Actuarial\ Liability}$$

$$\boldsymbol{Possible\ Future\ Formula}: \frac{Fiduciary\ Net\ Position}{Total\ OPEB\ Liability}$$

$$\boldsymbol{AFR\ Data\ Entry\ Form}: \mathbf{11}\boldsymbol{c}$$

Score Range	% of Potential Total
$[\mathbf{0}-\mathbf{1}]$	1.39%

- **Criterion 7: Change in Cash Balance (Unencumbered Cash)**

The inquiry into operating results may be further understood with the Cash Income Ratio. While the change in expendable net assets is an important representation of institutional performance, it is based on accrual accounting principles. Also of interest is the institution's cash position, given that the institution requires cash to operate. Cash flow information should be used to further examine the issue of the strength and quality of the income stream that was examined initially in the Net Operating Revenues Ratio. This ratio looks at the change in cash on-hand from FY-1 to FY-3. A declining trend of cash on-hand negatively impacts the assessment of an institution's fiscal health.

$$The\ \Delta\ in\ cash\ balance\ from\ year\ 3\ to\ year\ 2, and\ from\ year\ 2\ to\ year\ 1.$$

$$\boldsymbol{AFR\ Data\ Entry\ Form}: \frac{FY3:14 - FY2:14}{FY2:14}; \frac{FY2:14 - FY1:14}{FY1:14}$$

Score Range	% of Potential Total

$[\mathbf{0-6}]$	8.33%

- **Criterion 8: Audit Concerns**

This criterion looks at both the self-reported Material Weaknesses and Significant Deficiencies from Question 7 of the Annual Fiscal report and information in the institution's annual audit. Special attention is paid to reoccurring findings over multiple years. Currently only two years are considered but in the future three years will be used.

$$1\ Point\ per\ fiscal\ year\ that\ exhibits\ a\ material\ weakness\ or\ significant\ deficiency\ in\ its\ annual\ audit\ report;\ Points\ can\ be\ considered\ for\ late\ or\ Modified\ audits$$

Score Range	% of Potential Total
$[\mathbf{0-2}]$	2.78%

- **Criterion 9: Student Loan Default Rate**

During the tracking period for the FY 2014 borrower cohort (Oct. 1, 2013 to Sept. 30, 2016), more than five million borrowers entered repayment, and 580,671 of them—or 11.5 percent—defaulted on their loans. Those borrowers attended 6,173 postsecondary institutions across the nation. The FY 2014 cohort default rate is the percentage of a school's borrowers who entered repayment on a Federal Direct Loan (Direct Loan) Program loans between Oct. 1, 2013 and Sept. 30, 2014 and subsequently defaulted prior to Sept. 30, 2016. If an institution has a default rate over 30% it is subject to federal penalties. A rate significantly in excess of the national average could indicate that an institution is too heavily reliant on federal student loans and could be too aggressively marketing to students with a lower capacity of repaying the loans or obtaining their educational goals. This criterion begins to apply risk points at 25% and above.

$$\left.\begin{array}{c} USDE\ official\ cohort\ Student\ Loan \\ Default\ Rate, FSLD \end{array}\right\}\ for\ 3\ fiscal\ years$$

$\boldsymbol{AFR\ Data\ Entry\ Form}: 22$

Score Range	% of Potential Total
$[\mathbf{0-15}]$	20.83%

- **Criterion 10: Cash Flow Projections**

Criterion #7 addresses the importance of looking at an institution's cash position and cash position trends. That historical trend information is used by fiscally healthy institutions to project its cash needs on a regular, or even better an on-going basis.

1 point is scored for each year that a cash flow projection is not reported with a maximum score of 3. The self-reported answers are not verified unless the total fiscal health score identifies an institution for follow-up study.

$$\left.\begin{matrix} \textit{Does the institution prepare cash flow} \\ \textit{projections during the year?} \end{matrix}\right\} \textit{for 3 fiscal years}$$

$\boldsymbol{AFR\ Data\ Entry\ Form}: 15$

Score Range	% of Potential Total
$[\mathbf{0-3}]$	4.17%

- **Criterion 11: Active Negotiations**

The AFR is due by April 1st following the end of a 7/1 – 6/30 fiscal year or after the completion of annual audit for other fiscal years. Given that compensation costs can be over 90% of an educational institution's general fund expenditures not having signed compensation contracts by the time of the completed audit makes financial planning extremely difficult and may be an indication of underlying financial and/or financial reporting issues.

1 point is scored for each year that a negotiation remains open with a maximum score of 3. The self-reported answers are not verified unless the total fiscal health score identifies an institution for follow-up study.

$$\left.\begin{matrix} \textit{Do any negotiations which begain during} \\ \textit{the reporting period remain open?} \end{matrix}\right\} \textit{for 3 fiscal years}$$

$\boldsymbol{AFR\ Data\ Entry\ Form}: 20b$

Score Range	% of Potential Total
$[\mathbf{0-3}]$	4.17%

- Criterion 12: Excess Leadership Change – Executive Level

  Excessive turnover in the executive leadership can be an indication of a host of fiscally related issues such as lack of resources identified to competitively compensate the leadership; board/CEO disagreement on fiscal policy; reserve levels; budgets; compensation negotiations; and direction of the institutions strategic plan.

  2 points are scored if there are more than 1 executive or senior leadership change reported. The self-reported answers are not verified unless the total fiscal health score identifies an institution for follow-up study.

  Where there any executive or senior administration leadership changes at the institution during the most recent fiscal year?

  AFR Data Entry Form: 23

Score Range	% of Potential Total
$[\mathbf{0-2}]$	2.78%