HIGHER EDUCATION COORDINATING COMMISSION
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Docket Item: 4.0 - Financial Monitoring: Purpose Statement and Recommendations

Summary:

This docket item updates discussions around a purpose statement to guide HECC financial monitoring of Oregon public institutions of higher education and includes staff recommendations for the annual financial condition report. Supporting information is included in the appendices.

Docket Material:

Background

A budget note in HB 5024 (2019) directed the Commission and Oregon's public universities to coordinate on the collection of financial data and report to the Legislature. The first edition of the Financial Condition Analysis Report was submitted to the Legislature in August of 2020. Since then, HECC staff has made this an annual report providing information on the financial condition of the state's public universities.

The report uses financial ratios to calculate a composite financial index (CFI) to provide an overall assessment of the financial health of each public university. Additional information is provided on general education fund activity, enrollment, and tuition/fee revenue. During the April 2023 F&A subcommittee meeting, several questions arose around the purpose of financial monitoring and the report itself. A draft purpose statement was shared in June and a commitment was made to present a revised statement along with staff recommendations for the report at a subsequent F&A subcommittee meeting.

Purpose of Financial Monitoring

As noted in June, financial monitoring work in general could serve a number of purposes. It could include public institutions, private institutions, workforce boards, both two year and four-year sectors, among other elements. It could focus solely on a financial condition analysis, like the current report, or it could seek to address other concerns and provide other information. For discussion, a set of operating assumptions is outlined first with a revised purpose statement intended to guide future financial monitoring work for public institutions:

Operating Assumptions

- Oregonians are best served by a higher education system that combines centralized coordination with local governance and management. The governance of the institutions is best left to the independent governing boards.

- Financial viability, sufficiency, and sustainability, across all funding sources, are the responsibility of the independent boards. For clarity, the state is concerned particularly with the financial viability of the institutions' education and workforce mission as it relates to learners' ability to achieve success.
- The HECC is the state's agent in fostering collaboration and coordination among public institutions of higher education. HECC observes the work of institutional boards in maintaining financial viability and stewarding public resources and serves as a trusted advisor reporting to the legislature on these matters.

Revised Purpose Statement
The purpose of financial monitoring will be to support statewide policy making guided by the goals and mission of public higher education in Oregon. Specifically, financial monitoring will seek to:

- **Provide advance warning** of financial instability for policy makers;
- **Identify potential systematic risks** to Oregon's higher education infrastructure with a particular focus on the education and workforce mission of the institutions; and,
- **Maintain an awareness** of broader institutional finance trends to inform the HECC's budget request (ARB) and related recommendations for the Governor and Legislature.

Surveys and Additional Information
To address the questions that arose during the April 2023 F&A subcommittee meeting and to inform the staff recommendations, several collaborative activities were accomplished:

- A survey was conducted in partnership with the State Higher Education Executive Officers Association (SHEEO) to better understand how other agencies like the HECC approach financial monitoring work. A summary of findings is included in Appendix A. Also, a representative sample of reports and analysis from other states was reviewed as summarized in Appendix B.
- A survey of the universities was conducted to better understand how they use information from the existing Financial Condition report. A summary of findings is included in Appendix C.
- Internal conversations were conducted with certain HECC offices to understand how existing financial monitoring work is being conducted throughout the agency. A summary of these conversations is included in Appendix D.
- Several external resources were consulted to inform the staff recommendations. A select bibliography is included in Appendix E.

Other Organizations Involved in Financial Monitoring
There are other organizations, outside the regulatory triad of state agencies, accrediting bodies, and the federal government, who are involved in monitoring the financial health of public institutions of higher education. The most prominent include credit rating agencies, investors, and others who may perform similar analysis.

Of the largest, national credit rating agencies, Moody's Investor Services is the most prominent to cover institutions of higher education. They rate the debt sold independently by institutions to provide potential investors an understanding of the institution's financial health and more specifically their ability to repay the debt. Their financial framework considers scale, market profile, operating performance, financial resources and liquidity, leverage and coverage, and financial policies. They also consider qualitative and contextual information when determining a credit rating.

The Northwest Commission on Colleges and Universities (NWCCU) is recognized by the US Department of Education and the Council on Higher Education Accreditation (CHEA) to accredit postsecondary institutions. Legally a non-profit corporation, NWCCU accredits institutions of higher education in Alaska, Idaho, Montana, Nevada, Oregon, Utah, Washington, and British Columbia. It recognizes institutions for performance, integrity, and quality to merit the confidence of the education community and the public.

The standards NWCCU uses to assess institutions include an assessment of governance, resources, and capacity. Specifically, standard 2.E.1 assess whether the institution utilizes relevant audit processes and regular reporting to demonstrate financial stability, including sufficient cash flow and reserves to achieve and fulfill its mission. Additionally, standard 2.E.2 assess for appropriate available funds, realistic development of financial resources, and risk management to ensure short-term financial health and long-term financial stability and sustainability.

The federal government has played a role in providing oversight of higher education through institutional eligibility for student financial aid programs. According to the Higher Education Act (HEA), institutions must be financially responsible to participate in Title IV, HEA programs. Related regulations identify the criteria that public, private, nonprofit, and proprietary institutions need to meet to demonstrate that they are financially responsible. The US Department of Education (DOE) has recently released proposed rule changes adjusting these requirements. The rules go in to effect on July 1, 2024.

The new rules spell out what an institution must do to satisfy its financial and administrative obligations. Mandatory and discretionary triggering events have been added that may lead to a determination that an institution is not financially responsible. Institutions are then required to provide financial protection for each trigger.

Financial responsibility for public institutions specifically is increased. They are required to submit a letter confirming that the institution is a public institution backed by the full faith and credit of their appropriate government entity. Although they are not subject to triggering events, if they meet the criteria that would result in a triggering event, they could be placed on heightened cash monitoring, have additional reporting requirements, or have a negative action taken against them by DOE.

Emerging Recommendations

The following recommendations are offered related to financial monitoring of Oregon public institutions of higher education and the Financial Conditions report. These recommendations focus on public institutions, noting that HECC's Office of Workforce Investments already monitors local workforce boards and HECC's Office of Academic Policy and Authorization conducts some monitoring of non-exempt private colleges, universities, and career schools.

An annual report should be published that focuses on the financial health of Oregon public institutions of higher education including both community colleges and public universities. The report should be based on annual audited financial reports and other data collected. The report will serve as a reference for higher education interest groups and will inform the Commission's work and decision making related to the agency request budget, strategic planning, and other policy areas.

This recommendation ties to all three components of the purpose statement. It is consistent with the SHEEO recommendation that the commission engage in some way to monitor the fiscal health and risk of the institutions within our state. Also, it is consistent with what most states are doing to monitor institutional financial health.

The report should include both quantitative and qualitative data for appropriate context. Financial data will be used to illuminate the current condition of the institutions using the CFI framework as measured over time. However, qualitative data is necessary to provide context. Non-financial factors affecting the institution need to be included.

The CFI framework is a commonly used tool that provides an assessment of an institution's overall financial health. Employing financial ratios, it assesses four dimensions across all funding sources, including related foundations if appropriate, to provide a unified measure on a scale of one to ten. It, or the underlying ratios by themselves without the CFI calculated, is the predominate tool used by most states in financial monitoring work. A version of the framework is used by the US Department of Education for financial responsibility scores of private institutions and data for the related ratios is now reported by the institutions in the Integrated Postsecondary Data System (IPEDS) as of 2021.

There are some common criticisms of the framework. One is that the data used is historical and may not offer much situational awareness in an environment where circumstances are changing rapidly. Also, that the calculations are influenced by factors outside the board's control (like pension liabilities and contributions) and may necessitate the use of additional liquidity metrics. These can all be addressed in various ways especially with the collection of pro forma data as needed.

Recent academic research has shown that several factors can lead to an increased risk of financial instability.[1] These factors include a decline in the financial responsibility score, sharp declines in enrollment and total revenue, an increased reliance on tuition, and poor performances on federal accountability measures. It should be noted that other research shows most private colleges identified at being at the highest risk of closure via these factors remained open for years after leading to practical and ethical concerns with using financial results in the policy process. However, it is expected the Financial Condition report will include similar factors.

The report should include an analysis of broader, systematic financial trends. This is consistent with the purpose statement's intent to maintain an awareness of broader trends to inform the Commission's policy making work. This may include reporting on revenues, expenditures, fund balances, tuition and fees, staffing and salaries, completion rates, and other factors. This could also include information on evolving circumstances as necessary. Some specific examples are:

- Revenue and spending per student disaggregated by student characteristics to assess equity implications.
- National and state trends related to enrollment, tuition and fee rates, and other issues.
- Situational awareness of temporary conditions like substantial changes in pension fund contributions, non-financial issues like COVID, or other trends like inflation.

Additional collaboration and coordination are encouraged among HECC offices within the level of staff resources available. Since three offices within the HECC are engaged in financial monitoring in some form or fashion, additional collaboration and coordination should be expected to ensure proper alignment. This complements the purpose statement's intent of maintaining an awareness of broader trends.

Specifically, this could take the form of periodic meetings (annual, semiannual, quarterly) between the offices to discuss financial trends within their respective sectors. This could lead to more technical support between the offices as staffing allows. This could also lead to a combined, structured update and/or discussion with the Commission as necessary to support its policy making which may be specific to the HECC's Agency Request Budget (ARB).

Additional interaction is also encouraged with NWCCU. It has broad responsibility to accredit postsecondary institutions in Oregon and authority to collect data as needed in support of that mission. A partnership between NWCCU and the HECC could further complement the purpose statement's intent of maintaining an awareness of broader trends in that they can offer information about regional trends among institutions across states.

[1] Kelchen, Robert, 2020. "Examining the feasibility of empirically predicting college closures." Economic Studies at Brookings. https://www.brookings.edu.

Staff Recommendation:

Discussion only.

Appendix A: Summary of Findings – Survey of States

To gain a better understanding of how financial monitoring work is being conducted in other states, a survey was conducted by SHEEO during June 2023. In all, 28 states responded. The questions included:

- What type of financial monitoring is conducted?
- Which institutions (two-year, four-year, local workforce boards, public, private, etc.) are included in the analysis?
- Who is responsible for conducting the analysis?
- What thresholds are used to determine if additional action is required?
- What authority does the SHEEO agency have to require additional action?
- How are financial monitoring results reported?

The responses to the survey allow for the following conclusions:

- Most states focus their ongoing, financial monitoring efforts on public institutions with the majority conducting monitoring of the public, four-year institutions and public, two-year institutions to a lessor extent.
- The predominate type of monitoring work performed for the public two-year institutions included collecting audited financial statements. Only half of states calculated a CFI with less than half considering fund balances or cash flow. Other activity noted included considering enrollment trends, leadership turnover, and late or missing compliance reports.
- The predominate type of monitoring work performed for the public four-year institutions included collecting audited financial statements and calculating a CFI. About half consider fund balances and/or cash flow. Other activity noted included looking at annual debt capacity studies or credit rating reports.
- The majority of states require their SHEEO agency to conduct the analysis with either the SHEEO agency collecting the data or the institutions providing the data separately.
- Financial monitoring results are not reported publicly in most states; however, about 40% of respondents reported publishing results on their website. This likely means, that for most states, a financial condition type report is not published separately from a summary of analysis (or the calculations) shared on an agency webpage.
- Although one-third of responding states indicated they use a threshold to require additional monitoring, most states do not have thresholds formally adopted in policy.

For those that do, the thresholds often include a CFI below a certain value, less than 60 days cash on hand, or a 3-year change in enrollment greater than 20%.
- The majority of responding states indicated they have authority for monitoring and reporting only with about a third reporting they could compel additional reporting and/or oversight if needed. For most, the specific corrective action required is determined on a case-by-case basis.

Appendix B: Summary of Reports and Analysis from Other States

Arkansas Division of Higher Education. Annual Financial Condition Report.
This annual report from the Arkansas Higher Education Coordinating Board is a thorough review of the finances of Arkansas public higher education institutions. It is centered on the financial condition of the public institutions including both two- and four-year institutions. The report contains a large amount of financial data, comparisons with other states, faculty salaries, auxiliary services, and athletic program spending along with a description of the formula funding model. The level of statistical detail is deep with state-wide information as well as individual institution detail. Financial tables cover the last five years.

Mississippi State Institutions of Higher Learning. Financial Ratios and Trends.
This report from the Mississippi Institutions of Higher Learning, Office of Finance and Administration is a full review of the state's four-year institutions using the measures of financial conditions. It has a solid purpose statement for using the ratios and provides direct comparison between all of the public four-year institutions. It includes a good use of graphical content. An emphasis is on comparing the individual institutions against each other. The final section contains the historical financial ratios for each institution for the past five years.

Texas Higher Education Coordinating Board. Financial Condition Analysis of Texas Public Community College Districts.
This report covers the 50 community colleges in Texas. After a description of the Composite Financial Index with each of its composites, a statewide composite financial index is calculated. Each component of the CFI is calculated on a statewide basis and tables and graphs are present for each measure. Individual community colleges are only listed in tables and graphs. Community colleges are assessed for financial stress.

North Dakota Univesity System. Annual Financial Review Report.
This report from the North Dakota University System is a full review of the system's four-year institutions using the measures of financial conditions. Its intent is to provide an understanding of the financial health of each university. It relies on the CFI framework and includes other metrics along with enrollment. A financial panel review process is used for those universities who score below a certain threshold using the CFI. National trend analysis is included for reference.

Ohio Department of Higher Eduction. Campus Accountability. Institutional Financial Ratios.
Staff from the Ohio Department of Higher Education calculate financial ratios using audited financial data for the public universities. This uses the CFI framework. The universities report data quarterly with projected end-of-year data during the second quarter. Thresholds are established. Any university not meeting the appropriate threshold is place on a fiscal watch which requires additional reporting and planning to ameliorate their financial position. The ratio calculations are reported on a public website.

Appendix C: Summary of Findings – Survey of the Universities

A short survey was conducted. All seven responded. Follow-up conversations were held with the VP of Finance and Administration (VPFA) for each university with additional staff participating. The questions are included below with a summary of responses provided.

1. Do you use the Financial Conditions Analysis Report published by the HECC? If yes, what is most useful/not useful? What changes or inclusions would you like to see in future reports?
    a. Most of the universities use the current financial conditions report for peer comparison.
    b. They would like HECC ratios to be consistent with KPMG metrics. Some believe there are fundamental problems with HECC staff calculations, including using restricted funds and foundation assets.

2. How do you monitor your institution's financial health internally (i.e., ratio analysis, forecasting, etc.), and how often is this done?
    a. The universities monitor the budget to actuals, as well as cash balances, gifts, and investments on a monthly/ongoing basis.
    b. They monitor investment reports quarterly.
    c. They publish their audited financial reports, cash flow forecasts, as well as internal ratio analysis annually.
    d. Long term, some publish a longer-term budget outlook, such as a 10-year forecast (OSU) and 5- year change analysis (PSU). Many of those who do not publish a long-term outlook expressed an interest in doing so but have concluded they lack staff capacity required.

3. What financial monitoring information is shared with your board? How do you communicate financial monitoring/viability with your boards, and how often is it presented to them?
    a. On a quarterly basis, all seven universities report to their boards the budget to actuals, including variances in the budget and action plans, if necessary, as well as investment performance, reserves, and capital balances. Typically, this is done through the Finance and Administration Committee of the board, then forwarded to the full board as needed.

b. On an annual basis, they ask their boards for approval of the operating budget and tuition and fee rates. They also report on the audited financial statement, cost driver analysis, as well as any institution specific reports like OSU's 10-year forecast, PSU's financial dashboard, and UO's 5- year E&G projections.

Appendix D: Summary of HECC Office Conversations

HECC Office of Workforce Investments

1. What types of financial monitoring does your office currently undertake?
   Regular monitoring of Oregon's nine local workforce boards. This monitoring is largely focused on programmatic and policy issues; however, as required by federal law, OWI staff do some limited fiscal monitoring. There is also some fiscal review of subgrantee recipients in the Oregon Serves program (Oregon's AmeriCorps branch).
2. Under what authority do you do your financial monitoring?
   Federal law since most programs are federally funded.
3. Is there something specific that triggers financial monitoring? Such as if an institution is below financial thresholds.
   Financial monitoring is triggered by a risk assessment conducted by OWI staff.
4. Are there types of financial monitoring you wish you could do but do not?
   a. OWI does not perform detailed financial reviews of any of their programs, nor do they have the general authority to request more detailed information if they feel that a program is not meeting its fiscal obligations. To be fair, the staff capacity does not exist to fully analyze the finances of programs even if they could get more financial data.

HECC Office of Academic Policy and Authorization

1. What types of financial monitoring does your office currently undertake?
   Financial monitoring of all institutions both upon initial application and upon renewal (which is every 1 to 2 years depending on the institution). In addition, they can, and do, require surety bonds for all institutions to protect students in case of closure and have the authority to order higher bonds if they think an institution is riskier.
2. Under what authority do you do your financial monitoring?
   Oregon state law and related administrative rules.
3. Is there something specific that triggers financial monitoring? Such as if an institution is below financial thresholds.
   If an institution falls below certain thresholds (or staff have reason to suspect the institution does not meet the thresholds) the office has the authority to increase monitoring activity.
4. Are there types of financial monitoring you wish you could do but do not?

- Since this office relies on self-reported financials and on the federal financial responsibility score (which lags at least a year), staff often do not act until an institution is already at or near failure.
- In addition, staff do not have the authority to regulate regionally accredited nonprofit institutions.
- Staff have, but do not use, existing authority to ensure all institutions submit financial reports in the same format, nor do they have knowledge to question the validity of submitted financial statements.
- Staff feel they lack the knowledge to properly evaluate/question financial projections, which can then lead to unnecessary surety bond requirements. They would like outside help or training to better monitor the financial stability of institutions.

Appendix E: Selected Bibliography

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