Appendix C:

Dr. Gilbert Stork
Superintendent/President
San Luis Obispo County Community College District (SLOCCCD)
P. O. Box 8106
San Luis Obispo, CA 93403

Dear President Stork:

The district has retained CBT to assist in developing a response to the Accrediting Commission’s show cause letter dated February 1, 2012. In the letter the Commission expresses concern regarding the district’s financial stability. Further the letter refers to earlier comments from the accreditation team report regarding Recommendation 7: Financial Planning and Stability. There was a specific concern noted by the accreditation team on the issue of long term debt in the form of COPs. The purpose of this letter is to summarize my evaluation of the district’s financial status and comment upon the fiscal plan under development by the district.

To accomplish this task I communicated with Vice President Sommer who then sent to me draft plan documents, 10/11 and 11/12 budget documents, pages from the state CCFS 311 financial reports and audits from the last several years. After review of the documents and development of follow up questions I spent a day on site first meeting first with VP Sommer and Chris Green. Later I met with co-chairs of the planning and budget committee and finally with a larger group of members on the accreditation steering committee. Also in attendance was Deborah Wulff, the Accreditation Liaison Officer. In each of the meetings I gained a greater understanding of local district concerns. The sessions were casual, very interactive with lots of discussion and brainstorming. Having completed that process and subsequent re-examination of the documentation, I have provided in this report my assessment of the district’s financial condition. It should be noted that I did not audit any records and worked with the numbers from district produced documents. The focus of my efforts was on the unrestricted general fund and as such I did not examine foundation records or capital projects plans.

Summary of Analysis and Findings

Statement from accreditation team report:

Recommendation 7 - Financial Planning and Stability

To meet standards, the team recommends that the college review and assess its long range financial and capital planning strategies to ensure sufficient funding levels for ongoing operations. The team also recommends that the college and the college foundation review and communicate the fiscal status of investments and implement appropriate protections to secure fiscal solvency.

In evaluating the district’s financial condition as it relates to Recommendation 7 I did so with the intent of being able to either affirm or deny the college’s progress toward compliance with the recommendation. My findings and conclusions are organized by topic areas.
Fiscal Plan

The district has committed to preparing a five year fiscal plan. This plan has already gone through several drafts but as of yet the college team is not satisfied with the outcome. This speaks to their sincerity and desire to produce a plan that has merit and value. In discussions with your staff, we talked about key elements of the plan. Because of the volatility and economic uncertainty of the times, the out years of a five year plan are extremely hard to address in detail. The approach to the plan is to put greater emphasis on the near term, re-evaluate the plan each year to enhance the details of years four and five and eventually move to a rolling three year fiscal plan.

A fiscal plan is normally in response to other leading plans such as the education master plan, facilities and technology plans. Again due to the prolonged financial contraction of the community college system these plans have been tempered with the near term goals being more modest. For now the main focus of the fiscal planning has more to do with maintaining a level of fiscal stability and protection of the district’s core services at a level which when new opportunities begin to emerge will position the district to capitalize upon them. It is a very practical and reasonable strategy given the present environment.

Within the plan specific issues both long term and operational are identified including actions to address them. Further the plan outlines a means for benchmarking and communicating progress toward resolution. It includes self assessment and acknowledges increasing cost pressures created by existing local decisions such as step/column salary changes and health benefit costs. It is important to incorporate these into the planning in that they have an impact even when the district does nothing. These increased costs are made more relevant when revenues are being eroded. Under more typical circumstances when the district is receiving growth and COLA funds from the state the impact of “normal costs of doing business” are less of an issue. The plan also incorporates discussion of revenue potential, categorical program support and FTES strategies.

The plan elements appear to be appropriate and thoughtfully developed.

Resource Allocation

The district is also in the process of evaluating how resources are allocated internally. The old process was a “bottom-up” approach whereas now the process will be “top-down”. That means starting with the strategic planning priorities of the district, including impact on student learning outcomes and determining how funding requests support those priorities. The planning and budget committee is working on a revised allocation request rating matrix, a handbook for the work of the committee and clear directions on how funding decisions will be submitted, evaluated, processed and funded. The district is drafting an Integrated Planning Manual which provides more detail on this topic.

Budget Performance and Fund Balance

California community colleges have been facing reduced funding for several years now. This has led to significant expenditure reductions and the use of fund balance to weather the lingering financial storm. The San Luis Obispo County Community College District like others has had to respond to this circumstance. In the 2008/09 year the college reached a plateau of FTES that entitled the college to an additional $1.1 million in base funding. Since the district was not far above the minimum level to sustain the added funding it decided to not budget the additional funding for planned expenditures but add it to the district contingency account. This along with other fiscally prudent actions resulted in the district’s ending balance improving at a time when that would not be anticipated.

The following list recaps the results of the last 4 years for the unrestricted general fund:
Ending balance 07/08 $3,742,555
Ending balance 08/09 $4,773,189
Ending balance 09/10 $5,249,882
Ending balance 10/11 $7,337,681
Ending balance 11/12 (est.) $4,100,000

It should be noted that the ending balance includes a 6% general reserve designated by the governing board and the balance is used as a contingency reserve.

As you can see the 11/12 year is expected to reverse the recent positive trend. The 11/12 state budget included reduction triggers which hit mid-year as well as unexpected shortfalls in property taxes and student fees. It was the prudent actions of the college in the previous years that has provided the resources to take this unusually large hit without going into crisis mode. The strength of the district’s fund balance served as an important financial tool to manage the erratic impact of state actions and allowed budget planning to occur over a two to three year period avoiding knee jerk reactions.

There is however, one aspect of budget performance which the district should take steps to explain clearly so that the college community understands how contingency funds are being managed. In looking at the budgets adopted in recent years and the actual results for each, the actual performance while favorable needs to be understood, communicated and reflected in future budgets. To illustrate this point if we look at the last 3 completed fiscal years we see the following:

<table>
<thead>
<tr>
<th></th>
<th>08/09</th>
<th>09/10</th>
<th>10/11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Budgeted outcome(deficits)</td>
<td>($361,692)</td>
<td>($1,359,165)</td>
<td>($2,027,188)</td>
</tr>
<tr>
<td>Back out contingency budgets included</td>
<td>$0</td>
<td>$1,207,182</td>
<td>$2,561,923</td>
</tr>
<tr>
<td>True budgeted outcome</td>
<td>($361,692)</td>
<td>($151,983)</td>
<td>$534,735</td>
</tr>
<tr>
<td>Actual Results</td>
<td>$807,790</td>
<td>$476,693</td>
<td>$2,087,799</td>
</tr>
<tr>
<td>Beginning Fund Bal</td>
<td>$3,742,555</td>
<td>$4,550,345</td>
<td>$5,249,882</td>
</tr>
<tr>
<td>Ending Fund Bal</td>
<td>$4,550,345</td>
<td>$5,249,882</td>
<td>$7,337,681</td>
</tr>
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District staff should provide analysis and clarification on how the actual budget performance differs from the adopted budget plan and determine if changes in the budget are warranted or if the differences are due to one-time events and make sure this information is shared with the broader college community. Further during the current year early detection of budget variances is important. A budget performance modeling tool as been shared with district business staff that will help accomplish this goal. It will be in the district’s interest to see budgets that are more closely aligned to the expected outcomes.

Recent external audits indicated unqualified opinions with no material weaknesses noted in the fiscal operations of the district. This is a positive affirmation of district business practices.
Budget Development

The district has modeled the two most likely scenarios for the 12/13 fiscal year based on information from CCLC and the State Chancellor’s Office. As a result the district has made a determination to reduce its spending by $3 million for the 12/13 year. As of this writing the district has already identified specific ongoing reductions totaling $2.5 million. There is some discussion as to whether or not the remaining $500,000 could be soft reductions, meaning they could be easily restored if circumstances warranted. That the district has moved quickly and aggressively to make the budget adjustments again indicates prudence on the part of the district. Included in the district’s analysis of the 12/13 fiscal year is the impact of the two scenarios reflecting the $3 million in reductions and the resulting ending fund balance. Also identified is the true operating results (real income less expenses) for 13/14. There is a variable of $1.1 million mentioned earlier related to the mid-size college basic allocation. If the district is able to sustain the necessary FTES level to retain that funding increase then under the worst case scenario going into 13/14 the base budget would be close to being in balance. Under the better case scenario the budget would have a bit of breathing room depending on how the $1.1 million is utilized. This is before factoring in increased costs of operations for 13/14. The overall fund balance would still maintain the board designated 6% reserve and the contingency reserve would be anywhere from $0 to $1 million.

In this environment, after 4 years of declining resources, the San Luis Obispo County Community College District at the close of the 12/13 year will be in pretty decent shape. Its ongoing budget will be near balanced and the district will still retain a respectable fund balance. This is not to suggest that the district achieved this easily. It required hard decisions, sacrifices and impacted the lives of employees and students.

COPs and Compensated Absences

A great deal of emphasis has been placed on the long term debt created by the sale of COPs in earlier years. The schedule of annual payments is due to increase in 12/13, level off at that point and then decline by 17% starting in 18/19. The COPs will decline significantly in 35/36 and be paid off in 39/40.

While it would be desirable to not be encumbered with this debt, that is not presently possible. The added payment has been incorporated into the budget planning and included in the discussions above regarding budget and fund balance impacts. The budget planning by the district has accounted for the COPs payments and taken the necessary steps to adjust its budget.

In looking at the commission’s concern regarding the long term debt I discussed with staff other areas of compensation which often create unreceded or long term expenses. These include retirement health benefits, vacation, comp time and banked load. Many districts do not have COPs debt but do have large obligations regarding these other cost categories. Districts with retiree health benefit costs are facing enormous challenges due to the growth in the retiree ranks and the ever increasing premiums. They are having to pay annual costs for current retirees and are expected to be setting aside funds toward the cost of future retirees. SLOCCCD has a very small retiree health obligation valued at just under $100,000. Most districts are looking at retiree obligations of many millions of dollars.

To place the concern regarding the district’s COPs payments in a financial context it is necessary to contrast it to the other long term debt issues of other districts. The COPs are predictable, stable and will not increase beyond the level anticipated for 12/13. The costs will in fact drop slightly in six years. This is in stark contrast to the path retiree health costs are on. Further when the timing is right the district may be able to retire its COPs via a successful bond election. No such opportunity exists regarding retiree costs. If I had to choose between having SLOCCCD’s obligation on COPs versus one for retirees health benefits the COPs is the easy choice.
The district has planned for and is making its COPs payments. It is a line item in the budget like many other expenditure categories and after the 12/13 year will not add to the operating costs of the district.

SLOCCCD up until the close of the 08/09 year expensed banked load as it was earned. This was a sound business practice. It was upon the recommendation of the external auditors that the district discontinued this practice. Now banked load is expensed when paid against the hourly instructional budget. While the district does not expense compensated leaves, it does budget $90,000 annually to cover compensated absences such as vacation and comp time. Many districts make only memorandum entries for such absences, establish no annual budget line for payments and treat them as ad hoc costs when paid out. In addition to these actions, SLOCCCD has worked to limit the accrual of both vacation and comp time to further limit its financial exposure. The steps taken by SLOCCCD in regard to these costs are helpful. It would be in the district’s financial interest to at some point record as expense banked load when earned to ensure that this obligation remains manageable.

Conclusion

I have been very fortunate to have had the opportunity to work with a number of California community college districts looking at many of the same issues facing the San Luis Obispo County Community College District. The district is smaller than most of those with which I have worked but in terms of the relative scale, the issues facing SLOCCCD appear to me to be more manageable and less onerous. The district has a reasonable fund balance, a solid plan to bring expenditures in line with available revenues and defined, limited, long term debt with which to contend. The fiscal operation can be made stronger and budget materials can be presented more clearly, but the underlying foundation appears to be solid.

Thank you for this opportunity to work with the San Luis Obispo County Community College District. I appreciate very much the participation, candor and openness of the staff with which I worked.

Sincerely,

Michael Hill
Consultant, College Brain Trust