Analysis of Audited Performance

CFO Colleague

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Introduction

Clark's Summit University has been in the news recently due to the wholesale furlough of its employees. Coincidentally, the University was required to submit a more comprehensive teach-out plan to its accreditor by last Friday. That plan was prompted by concerns registered by Middle States about the University's financial resources. Of course, a full furlough does not send a positive message about its capacity to continue in operation.

The University's stated reason for the furlough was that contributions failed to materialize as planned. We find this quizzical since donation revenues have tended to be consistent and, likely, predictable over the past few years. Moreover, the President stated without reservation that the University would be in full operation this fall. When donations couldn't be predicted and an accreditor' skepticism remains to be overcome, one has to believe that such a declaration is nothing more than wishful thinking.

This scenario prompted us to evaluate the information that is readily available for the university, including its audited financial statements, dating back to 2016. In the subsequent pages, we will review certain financial relationships to determine the trajectory of the University and gauge whether it will (or should) reopen for the coming fall.

Findings

It is estimated that the University received over $5 million in federal assistance in connection with COVID programs over a three-year period (2020 – 2022). Some of these funds were to be paid directly to students on a 50/50 basis while others have been *recognized* in the financial statements but may not have been *realized* (ERC grant) in cash. Nonetheless, the University lost around $1.9 million for FY 2023 and would have consistently lost money for the previous three fiscal years had the federal programs not been in operation. Net Tuition has been declining, as has the contribution from auxiliaries. Donations have varied from year to year but seemed somewhat predictable. Blaming a weeks-long furlough on a shortfall in contributions is thus hard to believe. Like so many others whose operational foundation is crumbling, one can surmise that the goal for donations was lofty and whatever was received was insufficient in offsetting a continued decline in student revenues.

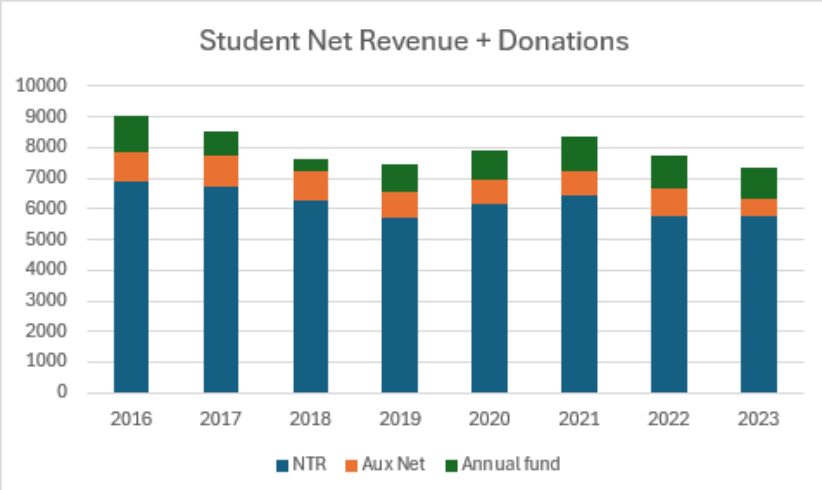
A. Controllable revenues

There are three revenue areas where the institution exerts significant influence and each has been declining during the years under review.

1. The largest component is net tuition revenue (NTR) and it is down from $6.7 million in 2016 to $5.7 million for 2023, a 17% decline. Our suspicion is that further declines occurred in FY 2024.

2. The net received from auxiliaries (room and board less associated expenses) went from $959K down to $611K, for a decline of 36%.

3. Donations fluctuated but declined from $1.18 million to 968K during the period under review.

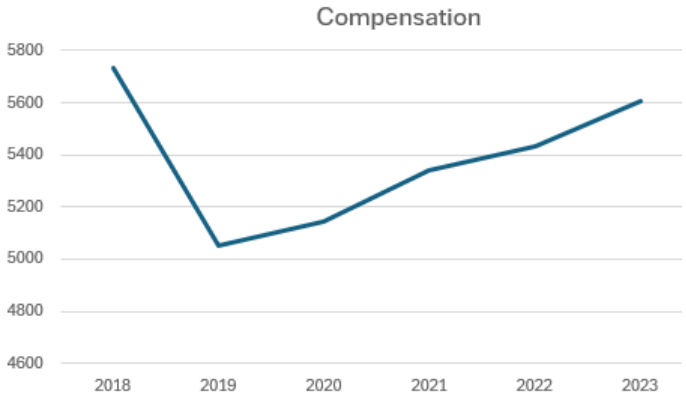


The data

	2016	2017	2018	2019	2020	2021	2022	2023
NTR	6893	6714	6259	5730	6188	6416	5791	5739
Aux Net	959	1026	960	822	767	804	891	611
Annual fund	1179	795	421	882	938	1123	1043	968

Our first finding is that the most controllable revenue components have been consistently declining since 2016. One can only expect further declines as demographics and regional church membership struggles impact enrollments going forward.

B. Compensation

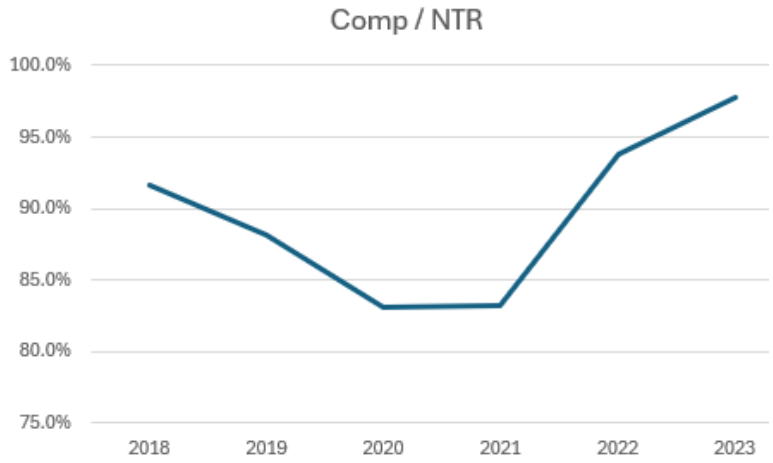


It would appear that a concerted effort to right-size the institution occurred in preparation for FY 2019. Unfortunately, like so many other efforts, the adjustments didn't stick and compensation (salaries and benefits) were back to within $100k of their former high point by FY 2023. Essentially, Covid funds were used to justify added compensation, even though it was understood that represented a temporary windfall and that student revenues were continuing downward.

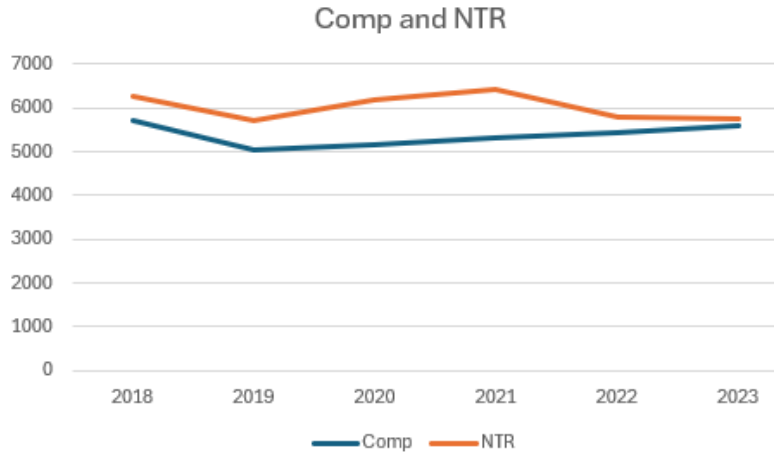
Our second finding is that there has been a lack of discipline with respect to compensation costs, with headcount likely growing since 2019. Increasing compensation represented a mismatch of funding timeframe when Covid relief funds supported new hires.

C. Compensation divided by net tuition revenue

One of the most telling ratios that we have found in our work with 200 institutions is compensation divided by net tuition revenue. Essentially, this compares the largest expenditure with the largest source of revenues. A healthy institution, with a low endowment, needs to be at 70% or less. As the following chart shows, the University far exceeds that ideal.



Note that the salary reductions for FY 2019 brought this ratio down to around 83%. While not near the established standard, it is far better than what was recorded for FY 2023. We don't know what the furlough will do to compensation costs for FY 2024 but, clearly, this ratio is headed for 100% or more. As revenues decline, the cost of people weighs heavily on performance. The University is no exception. Consider the following graph:



The data

	2018	2019	2020	2021	2022	2023
Comp	5732	5049	5144	5339	5433	5608
NTR	6259	5730	6188	6416	5791	5739

It is important to note that if the University had achieved the standard 70% relationship between compensation and NTR during FY 2023, comp would have been lower by around $1.6 million. The University lost $1.9 million that same year. Managing by ratios is critical in a world of declining NTR.

Our third finding is that the university appears to be unable to permanently redial compensation costs, actually increasing its largest operating cost as operating revenues declined.

Summary

On the whole, the data suggests that the University has little chance of continuing in operation. The reliance on a windfall of donations is a strategy based solely on hope. For the period under review, contributions have landed within a reasonable range each year, with but one exception. Net tuition revenues are consistently declining, however, as are those associated with auxiliary enterprises (room and board). With the largess of government grants ending in FY 2022, operating revenues in full retreat is unmasked, with little evidence of cost discipline, particularly with respect to compensation. Were donations really way off? We find that implausible in the face of declining operational revenues and growth in people costs. The wounds they contend with appear to be self-inflicted.

Another sobering statistic is that the University lost over $1.9 million in FY 2023, against salaries and benefits of $5.7 million. That loss exceeds one third of compensation costs! Again, had they managed to the standard of 70% compensation to NTR, they would have saved $1.6 million, making the loss more manageable. Added to the multi-year explosion in compensation is the suspicion that they are not dedicating anywhere near enough for non-

compensation areas. All of this begs the question whether they can cut another third out of their employee base. Alternatively, they could just not pay them for four months each year. That appears to be the current strategy.

The across-the-board furlough telegraphs financial stress to the extreme. The data tells us that this is not unexpected and there is scant evidence that it will be fixed any time soon. Again, the same administration that can't predict donations is assuring the public that this fall's operations will be as normal.

As a last consideration, compensation for faculty is a concern. Most faculty contracts are paid from August 1 through July 31 but the efforts required by faculty under those contracts tend to end in May. We are not familiar with the details of their specific agreements but wonder aloud whether a suspension of faculty payments is not a breach of contract. If faculty have satisfied their activity requirements, the funds are owed them and not subject to a suspension of payments. It seems as if there may be room for an action to be taken against the university should that be the case. This is conjecture on our part but it is a question worth asking.

In the end, we are not inclined to believe that the institution will be in operation this fall – or that it should be. It's hard to imagine Middle States being persuaded either.

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