Fiscal Year-End Update

August 7, 2013

Colleagues,

This is an update on the closing of the fiscal year for our University. To begin, there is good news. We did an excellent job managing elements within our control. Since we began implementing necessary changes to spending, including freezes in S&S, overtime and filling of new positions, we reduced our expenditures significantly over the last quarter of the fiscal year. Our projection of meeting a year-end fund balance of between 4.9 and 5.1 percent was very nearly achieved and we ended the year at 4.8 percent. Even though we fell slightly below the 5 percent minimum, we continue to receive support from the State Board of Higher Education and the Chancellor's Office, as our plans to meet these fiscal challenges by enacting critical next steps have been shared and accepted.

While this is all positive news, we have been notified that our fiscal year-end report will be changed as the result of a new system-wide policy. This policy was created and implemented by the OUS Controller and alters the manner in which each university calculates and accounts for "bad debt collection" of its accounts receivables. Previously, each university had its own policy for the accounting and reporting of bad allowances. This new policy is centralized and all universities will now follow the same procedures. The total fiscal reporting consequences of the policy, and the details of how it was to be implemented, were not known until late July just prior to the close of the fiscal year-end.

This is not uncommon. To remain in compliance with accounting standards, revisions of system-wide policies have occurred in this manner before. A very similar situation took place in 2002 when the accounting policies regarding vacation and sick-leave changed significantly, increasing the liability associated with these balances, which in turn had a negative impact on all of the universities' fund balances. In 2008, another policy change was made in how revenues for summer courses were allocated across fiscal years, which caused a downward shift in the fund balances for that year. These are examples of accounting policy changes, and while they do impact fiscal year-end reports, they do not impact our ability to meet day-to-day operational needs and cash flow.

As soon as I was made aware of the possibility of this new policy being implemented in mid-June, I met with the chairperson of the EOU Budget and Planning Committee and we discussed the ramifications of it and its centralized approach. Because there were so many unknown variables, including whether or not the policy would even be implemented, to what extent and the timing of implementation, we agreed to continue to monitor the situation.

Throughout June and into July, many conversations at the system level continued about how the policy would be implemented, if a write-off would be needed, or if alternative solutions could be found. It wasn't until the very end of July when the final calculation and justification was established that we, along with the other OUS universities, were made aware of the full fiscal reporting impact. In the end, the Chancellor's Office and the State Board of Higher Education made the decision to fully implement the new centralized policy for bad debt write-off.

In total, this policy change required over $20 million in one-time accounting adjustments and write-offs by the OUS in the recently closed fiscal year. The impact on the universities ranged from a low of $500,000 for one to a high of nearly $7 million for another. Of this total amount, EOU's one-time accounting adjustment/write-off was

just over $1 million, as ascribed by the Controller's Office. While our amount was among the lower levels in the system, it will reduce our fiscal year-end fund balance from 4.8 percent to 1.6 percent. None of the OUS institutions were able to anticipate or budget for the amount of the adjustment/write-offs, which resulted in reductions to the fund balances of all seven universities.

There are two important points for you to take away from this letter:

First, it is important to note this does not affect our cash balances, nor is it a "cash transfer" or a diminishing of cash flow; rather, it is an accounting adjustment much like capital depreciation, and the changes are to accounting mechanisms and procedures. EOU, along with SOU, are now reporting balances below the 5 percent minimum board policy. Our Sustainability Plan addresses how we intended to reach a balance of 7-8 percent. While this presents a new starting point for us to meet that challenge, I am confident that by adhering to the Plan we will reach our goal—but it will likely take a little longer than originally anticipated.

Secondly, the OUS board and Chancellor have reassured me that as long as we continue to make progress on our efforts, we will continue to have their support and will not be forced into financial exigency, nor will the board unduly require us to take further actions beyond what we have set forth in our Sustainability Plan. We are also addressing this with our accrediting body and it should not prove to be an issue, as we are dealing with the situation proactively. I have recently met with a working group of the Budget & Planning Committee and discussed this completely with them, and they fully support our efforts in dealing with this complex issue.

The OUS Controller has prepared a list of FAQ's on the new policy and its implications for the universities. I have copied it below. While this accounting adjustment is not good news, we will not be forced to significantly change our work or focus. It does, however, reinforce our need to be diligent in implementing the Sustainability Plan, to continue to control our expenditures and expand on our sources of revenue.

Should you have any questions, please contact me at your earliest convenience at president@eou.edu.

Sincerely,

Bob

Bob Davies
President

Frequently Asked Questions of the new bad debt policy by OUS

The Oregon University System Controller recently issued a new financial reporting policy that changed the manner in which each OUS university calculated its estimate of uncollectible accounts receivable. Prior to the issuance of the new policy, each university developed their own methodology for estimating the amounts of student accounts receivable that would not ultimately be collected. Accounting rules require that the estimate be based on actual collections history and the new policy sets forth a consistent methodology for all OUS universities to follow. The policy and methodology for making this estimate had not been reviewed for a number of years which, coupled with annual fee increases, a significant economic recession and the fact that we are serving more Oregonians from lower income families, means that the impact of implementing the change was significant. The policy change required a write-down of the net accounts receivable balance and resulted in a concomitant reduction in fund balances, including the education and general fund balance that has been a focus of OUS board policy for a number of years.

Below are frequently asked questions and related answers regarding this policy change and its impact on university finances.

1. *Why now? What triggered this review by the System office?*

   This review was requested by the OUS Finance and Administration committee. Economic trends over the past several years and each university's greater dependence on tuition revenues for operations prompted the board and system office to begin a review of the accounts receivable. Once it becomes apparent that an adjustment to an estimate such as this is necessary, it must be recognized immediately; phasing in the impact is not allowed by financial reporting standards.

2. *After implementing this policy, my university is now below the 5% minimum education and general fund balance required by the OUS board. Does this mean that we are insolvent and/or in financial exigency?*

   No. While this write-down of accounts receivable does reduce the university's education and general fund balances below the OUS board minimums, it does not trigger exigency nor indicate insolvency.

3. *What action will the OUS board take as a result of the reduction in fund balance below their policy minimum?*

   Current OUS board policy requires that when a university's education and general fund balance is below 5% of operating revenues at the end of a biennium, the university must develop and present a plan to the board that will bring the balance back up to the target 10%. There are no other requirements of the policy.

4. *Does this mean that the university now has reduced cash balances?*

   No. The write-down of accounts receivable does not impact the cash balances of the university.

5. *How does this affect the annual budgeting of the university?*

   The write-down of the accounts receivable balance reduces the carry-forward resources available to deploy and the implementation of the new policy going forward coupled with current collection rates may result in greater or lesser annual amounts of bad debt expense that will need to be covered in the budget. Otherwise, it does not impact the budgeting processes of the university.

6. *Is this the result of improper financial management at the university level?*

No. All entities that make sales on credit experience some level of uncollectible accounts as a result. Accounting estimates are made as a routine part of every financial reporting process and periodic reexamining and honing of the methodologies used to develop such estimates is a normal occurrence. As noted earlier, these estimates are impacted by actual collection rates which are impacted by prevailing economic conditions among other factors.

7. *Are all OUS universities impacted by this policy change?*

Yes. Every OUS university was required to adjust their accounts receivable balances to bring them in line with the new policy. The magnitude of the adjustment varied at each university based on its collection history, previous policies, etc.

8. *How will the implementation of this policy affect accreditation?*

Accreditation teams will focus a part of their review on the financial condition of the university. While a reduction in education and general fund balance will be viewed as a weakening of financial condition, there are multiple factors that will be evaluated as a part of the financial review. Ongoing operating results of both the education and general operations and auxiliary operations, the university's enrollment trends and enrollment mix, the expected future state funding, trends in major cost pools, etc. all will contribute to an evaluation of the university's financial condition. A single measure, such as the education and general fund balance, is not a complete picture. As a result, we are in the process of implementing a composite financial index that weights four separate ratios to monitor the financial health of OUS universities.