Memorandum

TO: Pamela Schulze, Ph.D., President, Akron-AAUP

FROM: Rudy Fichtenbaum, Ph.D., Professor Emeritus of Economics, Wright State University

DATE: August 28, 2020

RE: Dr. Storck's Memorandum—Exhibit 83 to the University's Opening Brief

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This Memorandum addresses the "critique" by Interim Chief Financial Officer Stephen Storck, submitted as University Exhibit 83 in the ongoing arbitration regarding Article 15.

My report stated: "Total revenues for the University in 2019 were $394.5 million." Dr. Storck misrepresents my statement on page 3 of his Memorandum, claiming: "The AAUP Report erroneously concluded that the University's **total** revenues for **General Fund budgetary** use were $394.5 million and that there was $129.2 million available to add to the General Fund to cover operating expenses." I never used the terminology "for General Fund budgetary use" nor did I claim that there was $129.2 million available to the General Fund for budgetary use.

Dr. Storck's presentation regarding the need to cut expenditures by $65 million was based solely on his analysis of the University's General Fund Budget. I was making the point that the General Fund Budget covers only a portion of the University's planned spending because I was well aware of the fact that there was also a Budget for Auxiliary Enterprises and a Budget for Sales and Services. First, for the record I will state that budgets are merely plans and ultimately what matters is what actually happens. The point I was making was Dr. Storck was looking only at a portion of the University's actual revenues by focusing on the General Fund and ignoring the other funds. This, in my view, is plain error; one needs to review all revenue sources and expenditures to have an accurate view of the University's finances.

He claims that I have created my own definition of total revenue which is inconsistent with GAAP and GASB. This claim is clearly false because the Ohio Department of Higher Education ("ODHE") calculates total revenue in exactly the same way as do I when they calculate total revenue for the SB-6 scores.

Attached as Exhibit A is ODHE's financial ratio analysis for FY2019. In this document, ODHE shows total revenue for University of Akron at $394,496,780. This number is obtained by adding operating revenues, non-operating revenues, state capital appropriations and other revenue, just as I did in my Report.

Dr. Storck in fact admits precisely the point that I made by comparing the General Fund to the total revenue from the financial statements when he writes: "In short, the budget does not contain all of the revenues and expenses that are included in the audited financial statements."

Dr. Strock recognizes that the "financial statements" are prepared using GAAP principles which include accrual adjustments, while budgets are prepared on a cash basis. Accrual adjustments are used in producing the Statement of Net Position and the Statement of Revenues, Expenses and Changes in Net Position, but they are not used in producing the Statement of Cash Flows. In 2019, if one looks at all of the cash inflows from operations, plus cash inflows from non-capital financing activities (including state appropriations and non-capital gifts), plus capital appropriations, capital grants, gifts, and interest on investments the total was $398,171,470 which is remarkably close to the total revenue of $394,496,780. This shows that the main effect of accrual adjustments is not on the revenue side but on the expense side.

Dr. Storck also writes on page 5: "**Notably, the AAUP Report did not mention the resulting Adjusted Change in Net Assets of a negative $11,400,000 which is indicative of an operating deficit for the year. Rather, the AAUP Report erroneously concludes, "On a cash basis the University in 2019 had a surplus of $24.9 million.""** This is a false statement. On page 38 of my Report, in Table 9, it clearly states that the adjusted change in net assets is ($11.4) million. But this does not in any way prove the existence of a budget deficit. Here, Dr. Storck seems to be doing exactly what he falsely accused me of doing i.e., not recognizing that accrual accounting, which produces the $11.4 loss in the statement of revenues, expenses and changes in net position, is different than the budget which is done on a cash basis.

In fact, in the same paragraph where Dr. Storck claims that I did not mention the ($11.4) million, he also claims that the University transferred $3,795,965 from operating reserves to balance its FY19 budget. So, if the $11.4 million loss was truly a budget deficit how do you get a balanced budget by transferring $3.8 million from reserves? You cannot. Dr. Storck is mixing accrual accounting and cash accounting. Furthermore, if the University had $82.7 million in unrestricted net assets and it transferred $3.8 million to cover a deficit then it would have had approximately $78.9 million in unrestricted net assets on July 1, 2020 not the $75 million, he claims on page 6 of his Critique.

One of the major differences between accrual accounting and budgets is that accrual accounting recognizes expenses while budgets recognize only expenditures. Depreciation is an expense, but it is not an expenditure, i.e., it is a non-cash expense. The University does not write a check to cover depreciation. Part of the $11.4 million loss for FY 2019 is due to depreciation, which totaled $46.3 million for that year. If depreciation is eliminated as an expense, the University would have had a surplus of approximately $35 million. However, this amount would include capital appropriations and gifts to endowments, neither of which could be used for operations. If you subtract that revenue, you are left with a surplus of approximately $26 million, which is remarkably close to the operating cash surplus noted in my report of $24.9 million.

Having an operating cash surplus is absolutely compatible with having a negative change in net position. This is why Moody's puts more emphasis on cash flow than on the change in net position when evaluating the credit worthiness of an institution.

In fact, Moody's just came out with a new rating for Akron. On August 24, they affirmed the University of Akron's A1 credit rating, the same credit rating mentioned in my report. A copy of that report is attached as Exhibit B. While Moody's changed its outlook regarding UA from stable to negative, its outlook for the entire sector of higher education changed from stable to negative which Moody's reported on March 18, 2020. A copy of that report is attached as Exhibit C. Here is what Moody's wrote regarding higher education generally: "The outlook for the higher education sector is changing to negative from stable, reflecting both the immediate negative financial impact of the coronavirus outbreak as well as other significant downside risks." Moody's notes that the biggest risk is for those institutions with weak operating performance and low liquidity. Ex. C. Moody's I its August 24, 2020 ratings update, Moody's notes that the University of Akron has "…preserved a good operating cash flow margin." Ex. B. They go on to say that "Monthly liquidity of 231 days cash on hand provides good flexibility to deal with near term escalation of financial and operational challenges." Ex. B. In its October 8, 2019 rating update, attached as Exhibit D, Moody's wrote: "Based on draft fiscal 2019 financials, the university's operating cash flow margin will exceed its already strong 21.6% margin in fiscal 2018." We have repeatedly asked the University for its draft financial statements; they have responded by telling us that the financial statements will be available on the Auditor's website in early 2021. Apparently, when the union asks for draft financial statements, they do not exist, but when Moody's wants to see draft financial statements they do exist.

Dr. Storck goes on to say at the top of page 6 that the AAUP report erroneously included expendable restricted net assets of $76,075,000. Again, I will refer you to the ODHE page for SB-6 calculations, (attached as Exhibit 16 to Akron-AAUP's Opening Brief), which lists expendable net assets for the University of Akron in 2019 as $158,783,562. The SB-6 webpage also shows the $76,074,872 in restricted expendable net assets, exactly what I say in my Report and which Dr. Storck falsely claims is a mistake. The difference between these two numbers is $82,708,690, this being the unrestricted net assets of the University.

Dr. Storck goes on to state on page 7 that my claim that restricted expendable net assets could potentially be used to cover debt and interest payments, scholarships and other expenses associated with restricted funds is "simply not accurate." Clearly restricted funds that have been set aside for scholarships can be used for scholarships. What about debt and interest payments? Let me quote from the University's Audited Financial Statements for 2019 (attached as an exhibit to Dr. Storck's Critique and labeled as University Exhibit 83A): "Expendable restricted net position represents funds that have been awarded or gifted for specific purposes, funds used for capital projects and **debt service**, and funds held in university loan programs. If restricted and unrestricted assets are available for use, restricted assets will be used first." P.20 (emphasis added).

I will not comment on Dr. Storck's discussion of enrollment except to say that my Report (which was written in July without the benefit of hindsight) stated that it was likely that the University was overstating the decline in enrollment. That is exactly what happened.

With regard to SSI, Dr. Storck's projection of a $65 million draw from reserves was the basis for invoking force majeure and firing faculty without notice. This calculation was based on a gross overestimate of the decline in SSI (in addition to the overestimated decline in enrollment). The fact that the Chancellor included a warning label is beside the point. Every other institution in Ohio got the same warning label but none of them are firing tenured faculty. And the statement says that the amount *could* change *if* state revenue were to significantly worsen. So far there are no signs that the state's revenue will significantly worsen. Yet the Administration and Dr. Storck continues to act as if the sky is falling.

Dr. Storck includes a long discussion on CFI to divert attention from the University's SB-6 and Moody's scores, both of which are shown in my Report. CFI was a methodology originally developed to analyze private universities and later became applied to public institutions. CFI uses almost the same raw data to calculate ratios as ODHE uses to calculate SB-6 scores: the primary reserve ratio, viability ratio, return on net assets and net operating revenues. Like the SB-6 score, it does not consider cash flows. However, like all performance indices it takes a variety of ratios, calculates scores (in the case of CFI it uses strength factors) and then takes a weighted average of those scores. CFI methodology gives a slightly higher weight to the viability ratio, a much lower weight to the primary reserve ratio and significantly higher weight to income performance than the SB-6 scores calculated by ODHE. It also is calculated on a scale of -4 to 10 which is a 15-point scale (as opposed to 0 to 5, a 6-point scale, for SB-6 or 20 to 0 in the case of Moody's Weighted Average Scores). It also converts these scores into totally arbitrary normative statements like "re-engineer the institution." It calls for re-engineering the institution when scores are between 1 and 3. A score of 1 is the 6th score out of 15 and 3 is the 8th score out of 15 i.e., just past the mid-point between -4 and 10. That is roughly equivalent to a scores of 2.4 to 2.7 using ODHE's SB-6 scoring. So, while a 1.1 might seem like a low score it is not that much lower than Akron's SB-6 score which was 2.8 for 2019. Also, of note is that a score of -2 is what prompts the recommendation to "consider whether financial exigency is appropriate" – that is, a lower score is required before a "normal" retrenchment pursuant to Article 15 would be appropriate to consider.

What is truly revealing about Dr. Storck's discussion of Akron's CFI score is that he has allegedly calculated a CFI score for 2021. This would seem to suggest that the University at the very least has 2020 draft financial statements that it is refusing to provide to the AAUP.

Finally, let us look at the projected revenues and expenses for the first 11 months of FYE June 30, 2020, as set forth in the Administration's own document and attached as Ex. 15 to the Akron-AAUP's Opening Brief and discussed in detail on pages 15-17. The total revenues and expenditures for all three funds of the University (General Fund, Auxiliary Fund and Sales Fund) projected revenue is $312.2 million and projected expenditures are $296 million which is a surplus of $16.2 million. So, to repeat my statement where is the deficit? If there is a deficit in the General Fund, it is because they are transferring $19 million to cover the deficit in intercollegiate athletics. The only structural deficit at the University of Akron is the deficit for intercollegiate athletics.