

# ARIZONA BOARD OF REGENTS

## UNIVERSITY FINANCIAL OVERSIGHT

### ENHANCEMENTS AND EXPECTATIONS

The University of Arizona ended fiscal year 2022 with \$844.5 million in cash reserves. By the end of fiscal year 2023, that number dropped to \$704.5 million, a reduction of \$140 million.

The reduction was caused by a combination of planned expenditures of cash reserves and unanticipated expenditures authorized by individual budget units. Planned expenditures included investments in student success outcomes, increasing research, a transition to an on-campus dining program and some limited capital investments. Unplanned expenditures included impacts from inflation and higher than anticipated enrollment of students qualifying for financial aid. Overall, the majority of the university's budget units spent beyond their base budgets.

The university cash balance is typically expressed as a ratio known as "days cash on hand." Established and defined by Moody's, this ratio compares the ending cash balance against university expenditure patterns. An increase in expenditure reduces days cash on hand at the same rate as a reduction in cash reserves. Because the university both increased expenditures and spent down cash balances, at the end of fiscal year 2023 a combined increase in cash or reduction of expenditures of \$240 million would have been required to return the university to the standard of days cash on hand.

On November 2, the University of Arizona presented to the board the current status of their cash balance. At that time the board requested a report from the president on the university's ongoing budget deficits, including specific steps that the university will take to improve fiscal controls and begin to address budget shortfalls. President Robbins will present that report to the board at the board meeting on December 13.

#### Board Oversight

In response to the university's November 2 presentation, the board office has reviewed established financial oversight protocols and established principles. In addition to its governance and strategic oversight, the board holds each university president accountable. The board currently exercises fiduciary responsibility through a number of mechanisms, including policy governance, financial reporting, budget authority and audit oversight. To guard against the mistakes made at the University of Arizona, the board will reinforce existing financial management requirements and monitoring by implementing additional governance principles and review mechanisms to increase the board's insight into – and confidence in – university financial processes.

#### ABOR's Current Financial Reporting Cycle

The University Governance and Operations (UGO) Committee reviews financial reports formally three times each year, covering issues that follow the business planning cycle:

- *May* – The universities present annual operating budgets to the board, which includes their projections for the fiscal year that is ending and their assumptions/forecasts for the new fiscal year that begins in July.
- *October* – The universities present the financial results of the prior fiscal year and may update their annual operating budget forecasts for the current year based on actual enrollment for the fall semester, actual state appropriations, and other material revenue and expense variations.
- *January* – The universities present audited financial statements for the prior fiscal year, key financial metrics and updated forecasts for the current fiscal year as planning begins for the next budget cycle.

Each of these touch points represents a key transition in the financial planning cycle and is intended to provide the board with insights required for it to assess financial and operational risks and make decisions related to the universities' revenue sources (tuition/fees) and operational priorities (expenditure budgets).

Throughout the year, the board receives additional financial reports (e.g., cost containment reporting) and reports related to business processes (e.g. estimated deferred maintenance liability in capital plans) that provide additional context for decisions, monitoring, and analysis.

### **Proposed Improvements to Financial Oversight**

The board intends to take four additional steps to improve financial oversight of the universities.

1. Adopt a series of financial principals to guide university financial processes and board governance.
2. Enhance monitoring of university financial health.
3. Implement enhanced review of university budget and financial processes and structures.
4. Provide the University of Arizona support and specific reporting requirements through budget structure transition.

### **Financial Principles**

The board intends to codify the following financial management principles.

1. Each university will employ a centralized financial planning and budgeting process. Highly decentralized budget systems such as Responsibility Centered Management and Activity Informed Budgeting will be eliminated.
2. Each university will use a centralized management and control structure for information technology.
3. Each university will implement budgetary controls to prevent college, unit or program expenditures in excess of established budgets.
4. Each university will put budget controls on non-resident institutionally funded financial aid.
5. Universities must have specific board approval to expend cash reserves below established thresholds.
6. Universities will provide additional transparency in budget communication.

### **Enhanced Financial Activity Monitoring**

While the processes above provide the baseline for annual financial planning and analysis at the board level, an additional level of current year financial reporting will allow the board to see university revenue and expenditure patterns and trends more clearly, providing enhanced assurance related to the structural balance of the universities' budgets and sufficiency of cash reserve levels throughout the year. A more detailed analysis of university cashflows may include:

- Reporting on monthly operating cash balance, identifying trends and the impact of material one-time or unusual inflows and outflows.
- Identifying and explaining significant fluctuations from existing patterns and levels of cash flow.
- Adding a mid-year (six-month) financial update to the board UGO Committee January/February agenda, incorporating comparison of actual revenue and expense to prior year actuals, as well as fiscal year end projections, including days cash on hand.

### **Enhanced Financial Process Quality Assurance**

Beyond engaging with the universities for a more detailed view of financial affairs, the board will require additional quality assurance related to the financial controls and planning mechanisms at each university. While there is a wide range of financial planning philosophies that have been successfully employed in universities, the success of any model requires elements that incorporate the following design principles:

- Active engagement and communication regarding university and college priorities.
- Resiliency mechanisms to absorb and/or adjust for changes in the operating environment.
- Flexibility to maximize opportunities and minimize risks between budget cycles.
- Financial planning and analysis processes designed to monitor and effectively manage university-wide financial conditions.
- Accuracy in tracking and projecting financial outcomes at the unit and university levels.

To ensure that the universities' budget and planning processes remain relevant and responsive to these design principles and board requirements, the board will require a peer review process whereby each university will document their financial planning and analysis processes and a visiting team, made up of representatives from the board office and the other two universities, will engage the university's teams in order to evaluate the sufficiency and success of those processes. The visiting team will provide a written report to accompany the university's process summary for the board to review. The board will require the first round of peer reviews to be completed within 12 months of the adoption of the policy. After the initial reviews, one university will complete a peer review each year on a rotating basis.

The chief financial officers of the three universities, along with relevant board office staff, also will conduct an annual summit where each university will share innovations in how they budget, manage institutional cash, develop financial projections of various types, analyze deviations in expected outcomes, manage capital financing processes, etc. Each institution then will establish broad goals related to their financial condition, customized to their unique profile, demonstrating how their financial planning and analysis processes are designed to assist them in achieving institutional goals while maintaining financial equilibrium.

### **University of Arizona Support through Transition**

The board will ask President Robbins to engage outside expertise to assist the university in transitioning budget models and in implementing appropriate expenditure and budget controls and reporting.

The board chair may designate two regents as points of contact for the University of Arizona. Over the next twelve months, the president and the external consultant will report to the UGO Committee on the following:

- Progress toward and outcomes from implementing the president's report.
- Progress toward implementing a centralized budget process.
- Progress toward implementing new financial controls.
- Progress toward centralizing information technology functions.

The board also expects the university will review other administrative functions for potential centralization to create additional operational and financial efficiencies.