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How a $10-Million Accounting Error Rattled the U. of Hartford

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10–13 minutes

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Nothing seemed obviously amiss when the University of Hartford shared its end-of-year expense projections for the 2022 fiscal year with bondholders last summer. Anticipating a 3-percent decline in operating revenues, the university forecast that it would wind up spending around $171 million by the close of the fiscal year, around $4 million less than it had the year before. And even though a $3.8-million gap between operating revenues and expenses was expected, the university had enough cash on hand and credit available to absorb the losses without raising alarm.

But when Hartford released its audited financial statements last December, a more distressing set of circumstances began to surface. Hartford's actual operating deficit for the year exceeded $17 million — a loss that was $13.3-million deeper than its earlier deficit projection. Likewise, not only had Hartford failed to generate any positive net cash flow from its operations for a second consecutive year, but the university also quietly revised calculations of its net operating cash flow for the 2021 fiscal year from -$6.9 million to -$35.7 million. All of sudden, alarm bells were ringing.

How had Hartford come up with such inaccurate projections — projections the university had relayed to investors six months earlier as it closed on $25.5 million in bond financing?

In an unsigned notice sent to bondholders in January, Hartford wrote that it believed the projections and calculations it provided to investors last summer had been "erroneously made using the institution's budgeted expenses rather than its year-to-date actuals available at the time of the publication." Hartford also admitted that its projections and calculations failed to account for more than $10 million in actual spending on instruction, student services, and other institutional programs. In contrast to the projections Hartford had previously shared with its bondholders, which predicted earnings in excess of $11 million, the university now admitted those projections should have reflected just $626,000 in anticipated income for the 2022 fiscal year.

Of course, accounting errors aren't unheard of in higher education. In 2016, for instance, the Lone Star College system learned it owed more than $2 million in taxes assessed against commercial rental properties it owned. At Augsburg University, in Minnesota, President Paul Pribbenow in 2020 told faculty and staff members that the $1.7-million deficit his institution faced at the time could be attributed to a budgetary error, according to reporting by the university's student newspaper. And last year, employees at Seattle Colleges expressed disgruntlement when the system disclosed its deficit projections had overshot the mark to the tune of $14 million, the *Seattle Times* reported.

For Hartford, the notable and key objective now is to reassure nervous bondholders, who can exercise considerable power over a university's operations when an institution appears to be putting that set of creditors' investment at risk.

In a statement to *The Chronicle*, Molly Polk, Hartford's vice president for marketing and enrollment, wrote that the institution discovered the accounting errors in January 2023 and informed bondholders shortly thereafter. While acknowledging the university's ongoing efforts to be transparent with bondholders, Polk casted the discovery of the accounting errors as non-germane to the institution's true financial situation. In addition to a $175-million endowment, Hartford also had access to a $15-million revolving line of credit, Polk said. And regardless of the erroneous projections shared with bondholders, the institution's annually prepared and audited financial statements could be counted on for their accuracy, Polk wrote. Hartford was also current and not in default across all of its financial obligations, bonds or otherwise. The university attributed the accounting errors in its dealings with investors to a single person, who is no longer employed by Hartford. Asked by *The Chronicle* for the identity of the former employee, Polk declined to name the person.

“As we expect the independent report will detail, the individual responsible for preparing the erroneous calculations is no longer with the university,” Polk wrote in Hartford’s statement. “We have new leadership in our finance division, and we are confident in the university’s overall fiscal health and budget-planning processes.”

From 2019 until June 2022, Laura Whitney served as Hartford’s chief financial officer; the permanent position remained unfilled until February 2023. On March 15, Whitney responded to an email from *The Chronicle* requesting an interview, a request based on the premise that Whitney would be a knowledgeable source about Hartford and its finances given her tenure as an administrator until June 2022. Whitney wrote she was “not able to comment on anything that happened at the University of Hartford after [her] departure” and wished her “former colleagues at the university the very best during these difficult times for so many mid-sized private universities.”

After receiving Hartford’s statement a week later, *The Chronicle* sent a second inquiry to Whitney on Friday, offering her the opportunity to respond to Hartford's claim of individual responsibility for the erroneous calculations. Whitney did not respond by the time of publication.

Ratios and Ratings

Why did Hartford's $17-million operating deficit set off sirens when the institution's $3.8-million projected loss hadn't been a cause for concern? After all, the institution's reserves seemingly absorbed the actual $17-million shortfall just as easily as it would have withstood the projected $3.8-million loss. The answer lies in a 188-page document setting out the rules and regulations Hartford agreed to when bonds were issued on its behalf last year.

To remain in full compliance with the terms and conditions of its bond arrangement, each year Hartford is required to calculate a debt-coverage service ratio — a measure of the cash flow available to pay current debt obligations. For bondholders, the ratio represents an annual assessment of the risk underlying Hartford's operations. Generate healthy tuition revenues in excess of total expenses while effectively managing your institution's debt loads, and there's nothing to worry about. Ring up a ratio that falls outside of the bounds prescribed by investors, though, and the klaxons will start to blare.

To avoid violating this bond covenant in the 2022 fiscal year, Hartford needed to generate at least $10.3 million in income from its operations and other sources against $9.4 million in debt service. Instead, Hartford only managed to pull in $3 million. For failing to hit that prescribed target, Hartford's deal with bondholders required it to hire a consultant, who would make recommendations for how the institution can adjust its operations and in turn improve Hartford's ability to generate cash.

Hartford "agrees that it will, to the extent permitted by law, charter, by-laws or contract, follow the recommendations of the consultant," according to the official statement prepared for last year's bond issuance. Polk, Hartford's media representative, wrote in an email that the institution would "continue to manage [its] financial position and operations closely to ensure compliance with all financial ratios in the future."

But as with virtually all bond deals, the relief afforded to Hartford by investors extends only so far. If Hartford fails to generate enough income to match its total debt service for 2022-23, "an event of default shall be deemed to have occurred." Bondholders would then be able to declare the principal on all of Hartford's "outstanding bonds to be due and payable immediately." That said, bondholders regularly grant reprieves to institutions that are in default on their obligations, though such mercy generally does not extend into perpetuity.

Further complicating matters for Hartford is the BBB- status assigned to its debt from the credit-ratings agency, S&P Global Ratings, last year. Were S&P to adjust its rating on Hartford's debt downward (below BBB-), the university would be required by bondholders to start funding a debt-service reserve fund with cash, securities, and letters of credit — assets Hartford might have otherwise used to fund its day-to-day operations. A downgrade of Hartford's debt rating from BBB- would also trigger a change from investment-grade to speculative-grade (or junk bond) status. Just 23 institutions of the 351 colleges and universities graded by S&P were rated as speculative-grade investments, according to a

Chronicle analysis of an S&P-ratings inventory released for 2022.

S&P declined to address whether or not the surfacing of accounting errors at Hartford, as well as its recent challenges with cash flow and income, had or would lead to a review and reassessment of its debt. Speaking generally, Orla O'Brien, director of communications at S&P Global Ratings, said that while S&P had encountered instances in which restatements or corrections had led to credit reviews, not all reviews necessarily resulted in a ratings or outlook change.

The extensive array of financial reporting required of many institutions of higher education — whether it's from the U.S. Department of Education or other federal agencies, from state and local authorities or from bondholders — can also mean opportunities for accounting errors, said Sue Menditto, senior director of accounting policy at the National Association of College and University Business Officers. After such errors come to light, Menditto said many institutions form internal committees to examine their reporting processes, in addition to adding further layers of review "so that nothing gets out the door without it being double- and triple-checked."

As for Hartford, Polk said the university was hopeful that S&P would give it "the time to recover from a difficult fiscal year and allow our strategies, investments and new fiscal policies to improve our financial condition and operations."

"If, however, the S&P rating were to be lowered," Polk wrote, "the university has sufficient liquidity to fund the debt-service reserve funds in accordance with the loan agreements."