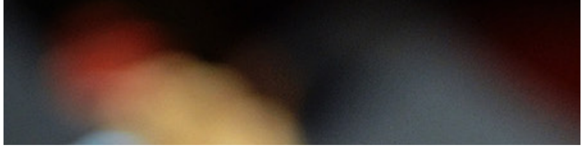

2014 Higher Education Update

Trends and Accounting Changes

January 2014

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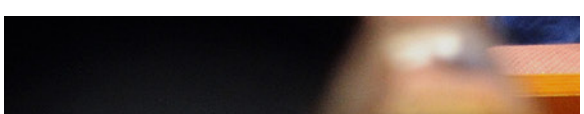

2014 Higher Education Update

TRENDS AND ACCOUNTING CHANGES

EXECUTIVE SUMMARY

CapinCrouse's annual *Higher Education Update* is designed to provide critical information and insight on the key trends currently impacting Christian higher education. The 2014 edition begins by examining three persistent myths about tuition, student debt, and the cost of private college, and provides the action steps higher education leaders can take to combat these negative perceptions.

The *Update* then addresses three big issues private institutions are facing:

- Economic factors, including the impact of reduced net worth and personal income, stubborn unemployment, and demographic shifts
- The negative outlook for private education held by capital market experts
- The effect of federal regulation on actual improvement within the higher education sector

The challenges these issues present are significant. Institutions must be flexible, strategic, and proactive in how they combat perception of higher education costs and governance, and this section provides data and best practices to help your school effectively address and plan for these issues.

The final section of this white paper highlights recent accounting changes, accounting standards updates, and key Financial Accounting Standards Board (FASB) projects that affect private higher education. This includes standards for lease accounting, not-for-profit reporting, the definition of a nonpublic entity, and recognizing revenue.

These current trends, issues, changes, and pressures have created a unique and challenging landscape for today's higher education leaders to navigate. We feel privileged to share this *Update* with you and hope that the data, analysis, and action items presented here will help your institution address pressing issues and strategically plan for future stability and growth.

2014 Higher Education Update

TRENDS AND ACCOUNTING CHANGES

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INTRODUCTION

The struggle to overcome great challenges is a common theme in literature. In *Gone with the Wind*, Scarlett O'Hara said, "As God is my witness, as God is my witness they're not going to lick me. I'm going to live through this and when it's all over, I'll never be hungry again." Many college administrators feel the same way. A tenacious approach to the challenges facing higher education today is gaining momentum and, like Scarlett, a determination to not be defeated. The higher education industry is full of smart, resilient people. It will take a very long time for any significant and broad industry defeat to take root, and it may never happen in wholesale fashion.

Many, however — including some high-profile professional service firms — have fallen prey to the temptation to read only the headlines and draw morbid conclusions about the future of the industry. Some in the audit profession are tempted by this "evidence-based" approach, but those who really understand the higher education industry realize how complex and multi-dimensional the issues and solutions are. The solutions are almost as varied as the number of campuses in the system. There are no "one-size-fits-all" solutions. Veterans in this industry understand its resiliency and will adapt.

The pressures still remain, however, especially on certain segments of the industry. The non-elite independent private colleges are probably facing the most significant pressure, followed closely by public colleges that are in the limelight of public perception and being asked to do more with less — and do it better. Will student debt, affordability, and shrinking state budgets — the main headlines these days — be the factors that derail many in the industry who may be considered stuck in an unsustainable model? Time will tell.

THE PROBLEM OF MYTHS

The higher education industry is being pelted with sensational headlines and dire predictions based on cynical assumptions and sketchy data. Much of it comes from a 24-hour news cycle that presses the media to get something — anything — that sounds meaningful out so that it can be processed, regurgitated, and put up as a shocking graphic with a "man-on-the-street" sound byte. The problem is that much of the data in the headlines is just the tip of the iceberg. The truth lies well below the surface, and the raw truth needs to be mined and then refined to be understood in context.

Consider the following three "myths" being disbursed as absolute truth when there is another story below the surface waiting to be explored. This material has been adapted from an open letter to President Obama written by the president of the Council of Independent Colleges (CIC), Dr. Richard Eckman, and summarized in the Fall 2013 issue of *Independent*, CIC's quarterly newsletter.[1]

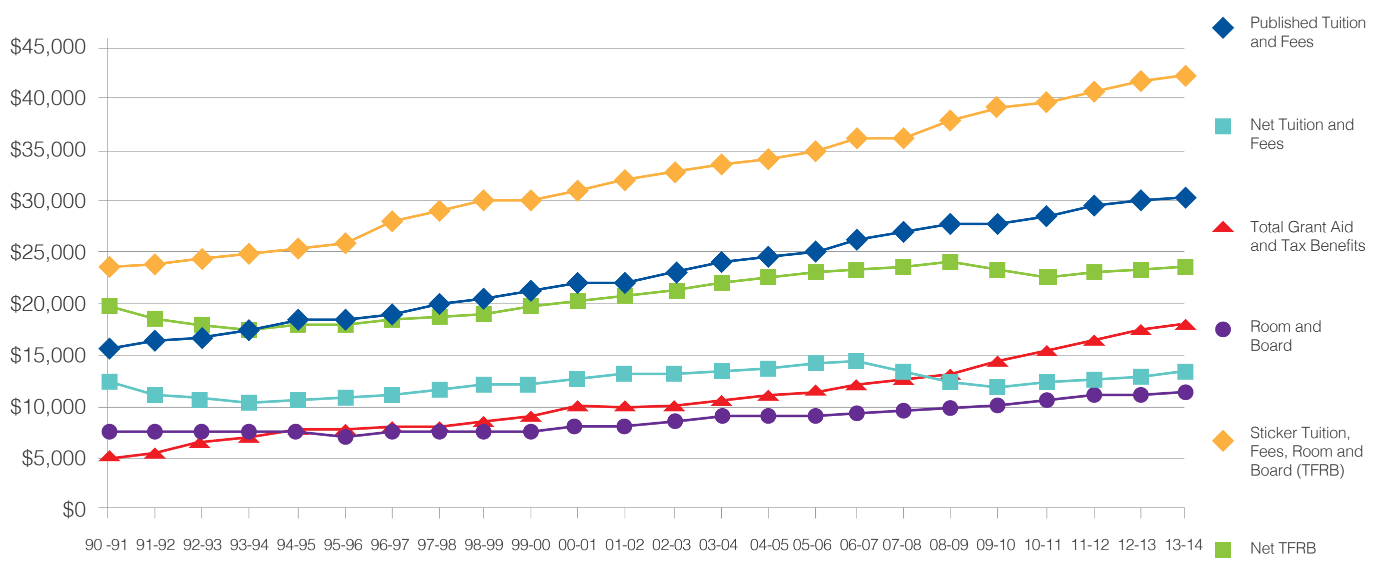
Myth #1: The higher education "sticker price" — often cited as $40,000 to $50,000 annually — is much more than a family can afford.

Some are talking about even higher numbers. In its "The State of Higher Education in 2013" report, Grant Thornton writes, "With sharp tuition increases and student and university debt at unprecedented levels, the annual cost of attending some private institutions hit the $60,000 mark last year."[2]

However, as Dr. Eckman notes:

> This is a misleading figure because students at private institutions on average pay about half that amount. Moreover, the "net" price paid at private colleges has actually

FIGURE 1



Note: Prices have been rounded to the nearest $10. Because financial aid data for 2013-14 are not yet available, financial aid and the resulting net prices for 2013-14 are preliminary estimates.

Sources: The College Board, Annual Survey of Colleges; Trends in Student Aid 2013; calculations by the authors.

decreased in recent years. And the increases in sticker prices have been smaller than the increases in student aid. Policy officials and journalists who use the "sticker" price as their yardstick rarely acknowledge these closely related facts. And one needs to retain a sense of proportion: People readily finance $25,000 for a modest-priced automobile that depreciates immediately and requires replacement in a few years, while questioning the wisdom of a similar level of debt for an education that gains in value over time and promises a solid, long-term return on investment.[3]

The rest of the story is that lower tuition prices are also getting headlines even as these dire predictions of high tuition hikes are being made. For example, *The Chronicle of Higher Education* recently reported on several colleges undergoing tuition resets, including Concordia University in St. Paul, Minn. Concordia cut tuition by 33% and ended up with 100 additional students. They only needed an increase of 24 students for the strategy to break even. The article also reports that Ashland University in central Ohio announced in late August 2013 that it would reduce its tuition by 37%. "If the college sees a 6 to 7 percent growth in students, it hopes to get an 8 to 9 percent growth in net revenue," the article notes.[4]

Most articles do not focus on this reported fact, but Dr. Eckman observes that average net tuition is actually down and has not changed substantially in over 10 years. In fact, the latest College Board pricing study, "2013 Trends in College Pricing," states that even "the 2013-14 increase in published tuition and fees at public four-year colleges and universities is the smallest we have seen in many years."[5]

Consider the following key points excerpted from the College Board study:

- On average, net tuition and fees for private nonprofit four-year institutions are lower in inflation-adjusted dollars in 2013-14 than they were a decade earlier — $12,460 versus $13,600. Undergraduates enrolled full time in private nonprofit four-year institutions receive an estimated $17,630 in grant aid and tax benefits to help them pay for college.

- The average full-time undergraduate enrolled in a private nonprofit four-year college receives enough grant aid to cover about 60% of tuition and fees, but not to cover any other expenses. As a result, total net price — including tuition and fees as well as room and board — equals the $12,460 in net tuition and fees plus the full $10,830 for room and board, yielding an estimated total net price of $23,290 in 2013-14.[6]

So the "unaffordable tuition" myth, spread by well-meaning but ill-informed reporters, is exposed. On average, schools have actually been trying to live with the same or fewer net dollars, and have been experiencing rising costs for 10 years or more. This comes at the same time federal government agencies are putting more pressure on the same schools to provide more data and jump through more regulatory hoops… all in the name of driving down cost and improving quality. More on that later.

CapinCrouse Action Items

1. It is time to take a serious and well-studied look at pricing strategy. Do this only with good data and good advisors. Look for a pricing strategy that will work for you, and do not rule out a pricing reset as an option. Schools with the largest gaps between sticker price and net price have the best chance at making a tuition reset work.

2. Recognize the squeeze occurring with net tuition flat or down and costs up. Adjust accordingly. The current model of holding down net tuition while experiencing upward pressure on costs is not sustainable long term. Work on both the revenue and the cost side of the budget will be necessary.

FIGURE 2

Published Tuition and Fees, Net Tuition and Fees, and Room and Board in 2013 Dollars, Full-Time Undergraduate Students at Private Nonprofit Four-Year Institutions, 1990-91 to 2013-14

Private Nonprofit Four-year	04-05	05-06	06-07	07-08	08-09	09-10	10-11	11-12	12-13	13-14
Published Tuition and Fees	24,720	25,080	25,610	26,260	26,360	27,920	28,680	28,830	29,560	30,090
Net Tuition and Fees	13,860	13,910	14,110	14,320	13,550	12,420	11,730	11,550	11,930	12,460
Total Grant Aid and Tax Benefits	10,860	11,170	11,500	11,940	12,810	15,500	16,950	17,280	17,630	17,630
Room and Board	9,150	9,280	9,400	9,620	9,530	10,120	10,390	10,430	10,660	10,830
Sticker Tuition, Fees, Room and Board (TFRB)	33,870	34,360	35,010	35,880	35,890	38,040	39,070	39,260	40,220	40,920
Net TFRB	23,010	23,190	23,510	23,940	23,080	22,540	22,120	21,980	22,590	23,290

NOTE: Prices have been rounded to the nearest $10. Because financial aid data for 2013-14 are not yet available, financial aid and the resulting net prices for 2013-14 are preliminary estimates.

Sources: The College Board, Annual Survey of Colleges; Trends in Student Aid 2013; calculations by the authors.
This table was prepared in October 2013.

Myth #2: Student debt is out of control and now totals $1 trillion.

Regarding this second myth, Dr. Eckman writes:

> Some officials conclude from this solitary statistic that if colleges rolled back prices, all would be well. These observers ignore the massive increase in the number of Americans who attend college, the much larger percentage of low-income students in college today, and the increases in financial aid from both institutions and state and federal governments. By viewing this number as a sign of overcharging by colleges, observers then too readily jump from the $1 trillion figure to the erroneous conclusion that aid is not being awarded to the students who need it most.[7]

Eckman goes on to explain the facts:

> Twenty-eight percent of private college graduates have no debt at all. Another 29 percent of private college graduates have total debt under $20,000, a small amount in relation to the premium on their lifetime earnings potential. Although all student borrowers have an average accumulated debt of $28,000, those who graduate have an average debt of only $20,000. Lest anyone conclude that financial aid awards favor academic superstars, the pattern indicates that aid is distributed in ways that track family income. In other words, the $1 trillion in student debt is a sign of an aggressive and laudable societal commitment to expand access to higher education.[8]

The attention-grabbing big numbers only tell part of the story about student debt. This lends itself to the mythology about higher education today.

One unfortunate truth about student debt remains, however: there is a lot of it and many students, especially first-generation college students, sometimes have a hard time figuring out how to navigate the system and make good decisions. It becomes important, then, to maintain or create support systems especially for these students — particularly at schools attracting a diverse student population. Since the recent tightening of loan eligibility rules, there have been reports of denial rates of up to 70% for students at historically black colleges. Then there are the reports of the steady climb in student loan default rates. The percentage of borrowers who defaulted within two years of starting repayment reached 10% percent in 2011, according to *The Chronicle of Higher Education*.[9] Although the total rate has continued to climb, it is important to note that the latest private nonprofit college default rate (three-year rate) was only 8.2%. This should be compared to a similar rate in the for-profit sector that reaches 21.8%. Much of the gain in the overall rate, then, is created by the for-profit sector, as it represents 31.8% of the borrowers and 43.3% of all defaulters.[10]

Finding good strategies to keep institutional loan rates down is important in some schools. Those that need good models for effective default rate management can look at some of the larger schools that have recently begun to do this more effectively. Georgia State University in Atlanta, for example, did its homework and, after calling students who dropped out, found that many had left for financial reasons. Some had not maintained academic results that were adequate enough to keep the important Hope Scholarship. Many did not understand funding sources and only needed some focused support to regain their scholarship status. The university also launched a program to increase financial literacy, with a focus on personal finances and debt management. Georgia State University president Mary Becker told *Business Officer Magazine*, "The reality is that we have to have systems in place not to lower the bar, but to support first generation students who don't have the advantage of knowing how the higher education system works."[11]

CapinCrouse Action Item

Evaluate your retention to see if there is a financial problem that can be fixed by small grants or additional counseling on financial aid and debt management. Rethink your strategies on personal finance and debt management training for students. Focus your efforts on the students who might need this help the most and do not let them slip through the cracks.

Myth #3: Only wealthy families can afford to send their children to independent colleges.

Eckman's article explains:

> In fact, independent colleges enroll students of all financial backgrounds and in about the same percentages as public institutions for low- and middle-income students. At private colleges, 22 percent of students come from families with incomes below $25,000 and another 19 percent come from families with incomes of $25,000–$50,000. (At public universities, the percentage of students in these two income brackets is only marginally higher.) Financial aid for students in these two income groups at both public and private colleges is generous—awarded so that the net price paid by students is less than half the total. In fact, the average family income of students at smaller, non-doctoral private colleges and universities is *lower* than the average family income of students at four-year public research universities. Private colleges commit more than six times the amount of their own money to student aid than their students receive from federal aid programs.
>
> Remember that the economy has been weak; the college-goers of today are less affluent than those of the past; state budgets have starved state universities; and endowment returns have been modest. Yet colleges and universities have expanded access, raised massive amounts of money for financial aid, and distributed aid in accordance with principles that are honorable. That is, the financially most vulnerable students receive the most aid, and students who have shown persistence in their studies and complete their degrees have much less debt than others.

A century ago, clinching a point in an argument meant citing an unassailable authority such as Aristotle, Thomas Jefferson, or the Bible. In our era the way to win arguments is to cite statistical evidence. Yet the dangers of imprecision in how statistics are used is at least as great as it is with high-flown rhetoric. Basing policy decisions on a 30-second sound bite and a summary statistic won't suffice.[12]

CapinCrouse Action Item

Many private Christian colleges have made huge investments in keeping the net price of college affordable for many students. They have kept tuition increases at a minimum and increased institutional aid. This, combined with the fact that students of all backgrounds have been found to graduate on time at private colleges, is a logical and convincing argument that admission counselors need to make to prospective students and their families.

Conclusion

Given the treachery in interpreting statistics, especially those that are so readily available in the popular media, what data and trends should private colleges watch? Are there predictive measures from accurate instruments that can be relied upon? Meteorologists have barometers, very sophisticated radar, and other tools to predict what is going to happen. Unfortunately, that type of sophisticated technology is not available to college presidents, CFOs, and boards.

The key to continued resiliency and long-term health seems to be the tenacity, nimbleness, and flexibility of individual schools. In the next section we will look at the biggest "giants" our schools face and put some recommendations into context to address these trends.

HIGHER EDUCATION TRENDS

Everyone seems to have an opinion about how well or how poorly private colleges are doing and what will happen to them in the future. One thing is certain, however — the fight for quality and sustainability in today's market is real. The strong and those with liquidity will survive. Those that are highly leveraged with little liquidity or financial flexibility will struggle.

One higher education president, addressing his faculty and staff this year, compared the issues their school faces to having encounters with "giants" (like the Philistine David fought with a sling shot and five smooth stones).

Borrowing that "giant" analogy, the giants faced by smaller, non-elite private colleges today are many. Among the largest and most potent are:

1. The economic giants
2. The perception giants
3. The regulatory giants

Our update this year will focus on these trends and issues, and point to some of the indicators that might warrant a watchful eye.

ECONOMIC GIANTS

The economic giants schools are facing include:

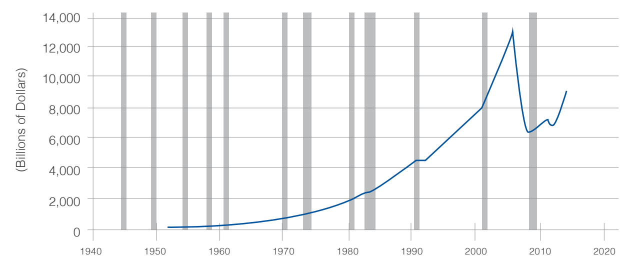
- Reduced family net worth
- Reduced personal income
- Stubborn unemployment
- Demographic shifts

Family Net Worth

In its 2013 "U.S. Higher Education Outlook," Moody's Investors Service reports that "the average American family experienced a 39% decline in net worth during the three years ending in 2010, bringing median net worth to its lowest level since 1992."[13] In addition, data from the Federal Reserve Bank of St. Louis shows that while owners' equity in real estate (a major component of individual household net worth) is currently rising, it is still substantially behind its peak in the second quarter of 2005.[14]

FIGURE 3

Households; Owners' Equity in Real Estate, Level (OEHRENWBSHNO)
Source: Board of Governors of the Federal Reserve System



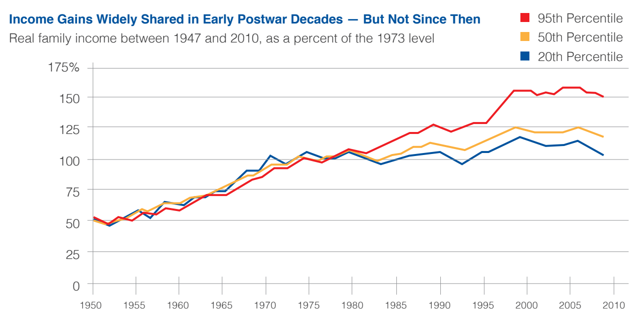
Shaded areas indicate U.S. recessions.
Source: 2013 research.stlouisfed.org

This demonstrates that there is still a lot of ground to make up before families feel they have enough economic cushion to enable a major expenditure like college education. They will likely remain cautious and look for the least expensive alternatives for the next couple years as they regain financial net worth. This might take a long time in some markets.

Reduced Personal Income

Figure 4 shows the growth in family income from about 1950 to 2010. The most obvious trend is the income growth from 1950 to about 2000. Since that time, there has been little to no growth in personal income in any of the three income segments. In fact, personal income for households in the 20th and 50th percentile of income declined from the peak in 2000. Likewise, the other two segments have recently pulled back. Personal incomes actually got back on a growth track in 2013, but the pace is very slow.

FIGURE 4



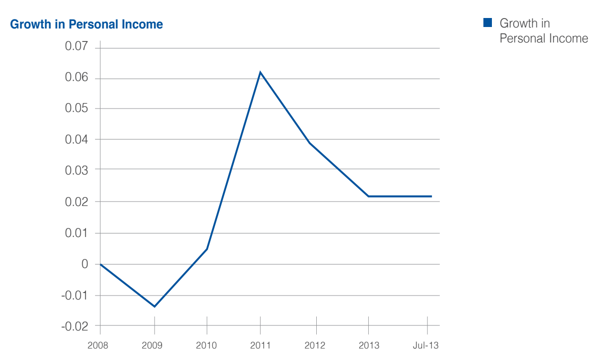
Source: CBPP calculations from U.S. Census Bureau data
Center on Budget and Policy Priorities | www.cbpp.org

As Spencer Jakab reports in *The Wall Street Journal* Online:

> Despite the rejoicing over last year's big drop in unemployment, the 3.3% growth in disposable personal income was the lowest since such records began in 1959, excluding the 2009 swoon. Stripping out December's surge in dividends and bonuses ahead of January's tax increases, income rose by a little less than 3% in 2012. This year is on track to be even slower.[15]

The following chart illustrates this:

FIGURE 5



Impact of Reduced Net Worth and Personal Income on College Decisions

Reduced net worth and the low personal income growth rate are causing many families to alter their plans for paying for college. These changes are laid out in detail in Sallie Mae's 2012 "How America Pays for College" study, which includes these points:

1. The dramatic post-recession decline in American families' spending on college that began in 2011 continued in 2012.
2. The average amount spent on college declined 5% in 2012.
3. American families surveyed said they were taking more measures to cut costs, and more families reported making college decisions based on the cost they can afford.
4. In 2012 parents reduced the contribution they made to college education through income and savings by 11% percent from the prior year and 32% percent from 2010.
5. The proportion of families reporting that they received scholarships from colleges decreased to 35% percent in 2012, compared to 45% in 2011. Grant and scholarship funding actually surged in 2009 and 2010, but has since declined.
6. This was an increase of almost 9% from 2011.[16]

Stubborn Unemployment

While the surface statistics appear to be positive, there are darker forces at work related to unemployment. In their 2013 third-quarter "Market Notes" update, our friends at Wilmington Trust explain that:

> Amid a slew of recent positive economic news—robust U.S. auto sales, an improving U.S. housing market, and an upward trend in global purchasing manager indices—there is a pocket of weakness that should give equity bulls pause. The lead article in the September 7–8 weekend edition of *The Wall Street Journal* affirmed what alert economy-watchers have known for some time: there is trouble beneath the surface of the declining U.S. unemployment rate. Federal Reserve policymakers have suggested that its bond purchases would likely conclude around the time that the unemployment rate reaches 7.0%—it's now 7.3%—and that conversations about raising its target for short-term interest rates could begin when the unemployment rate falls to 6.5%. However, as the firm 13D Research reported on August 1 in its flagship publication, WHAT I LEARNED THIS WEEK:
>
> > "The unemployment rate has fallen primarily due to people dropping out of the labor force—a situation unheard of during an 'economic recovery.' There has been little to no recovery in the overall percentage of the population that is employed which dropped from 63.3% in 2007 to 58.7% in October 2009 and remains near that level today. Nearly three times more people have left the workforce than have found a job in the current recovery. 73.9% of all new jobs this year have been in part-time positions. The current duration of lackluster full-time job growth is cause for concern and helps explain why real household income levels are not growing."[17]

It seems at least possible that, due to the growth of our part-time economy (as evidenced by the data provided by Wilmington Trust), fewer and fewer adults might be signing up for study as they no longer have time while they hold down multiple part-time jobs just to make ends meet. This might also give parents with multiple part-time jobs pause before they spend their hard-earned money on Junior's education.

Demographic Shifts

In a July/August 2013 *Business Officer Magazine* article, Gretchen M. Bataille, most recently senior vice president, Division of Leadership and Lifelong Learning at the American Council on Education in Washington, D.C., notes that 75% of college students are now "nontraditional." She explains, "That is, they are often in their mid-20's or older, retraining for new careers or certifications, transitioning from the military to civilian life and, by 2043, the latest census predicts, the majority will be nonwhite."[18]

Taylor University, a school that CapinCrouse partner Nick Wallace (the author of this white paper) is proud to serve as a trustee, has an initiative known as Mosaic. As you can imagine from a title like that, the initiative is focused on making the university a welcoming home for many different groups of people. This strategy is right on target. The latest National Center for Education Statistics (NCES) report on demographic and enrollment trends has some eye-opening data to consume and use in strategic planning. To demonstrate just how timely a Mosaic-type initiative is, consider that the increase in the enrollment of white students will grow at a pace of about 1% between 2010 and 2021, while the increase in Hispanic students could hit 46% and the increase in black students could go as high as 25%.[19]

The enrollment of women is also interesting. Enrollment of men in postsecondary degree-granting institutions is expected to grow about 10% percent between 2010 and 2021, while enrollment of women is projected to be about 18% during that period. In addition, enrollment of traditional-aged students (18-24) is expected to increase about 10%, with enrollment for older students growing twice as fast at about 25%.[20]

What does this mean for schools targeting a wider range of the college-bound population? Focused effort on new centers of enrollment growth is warranted in schools that have embraced expanded populations. Every idea from targeted financial aid to establishing learning communities where students with similar backgrounds can build personal connections and access tailored tutors is worth pursuing to insure success. Rolling the various elements of strategy into a comprehensive package seems to be one idea that is working on very diverse campuses.[21]

PERCEPTION GIANTS

Dismal Outlook

The current perception of private higher education is probably farther from reality than it has ever been. We previously covered three persistent myths. In addition to those items, even capital market experts like the analysts at Moody's seem to be at odds with some in the industry they serve. Catherine Bond Hill, president at Vassar College, writes that she finds Moody's recently issued negative outlook on the entire industry "puzzling on a variety of fronts."[22]

Hill is not only a college president, but also a development economist familiar with sorting out cyclical and temporary changes from the permanent ones. In her February 13, 2013, response to the Moody's outlook, she notes that many of the factors impacting enrollment and college financial health may be temporary. On the subject of tuition growth, Hill says, "If real income growth picks up, so will the ability of some institutions to increase tuition."[23]

In addition to the dismal outlook from Moody's, the consulting firm Bain & Company has captured national attention with its assessment of the financial health of colleges based on its two-ratio assessment process. The Bain website www.thesustainableuniversity.com has the following observations about the "liquidity crisis facing higher education" today:

> If you are the president of a college or university that is not among the elites and does not have an endowment in the billions, chances are cash is becoming increasingly scarce—unless you're among the most innovative. The reason is simple: Approximately one-third of all colleges and universities have financial statements that are significantly weaker than they were several years ago.[24]

Citing the outcomes of the two-ratio assessment, the Bain authors continue:

> On the balance sheet side, the equity ratio (equity as a percentage of assets) is down—sometimes way down. On the income statement side, the expense ratio (expenses as a percentage of revenue) is significantly up. And, to make matters worse, endowments have taken a major hit and are not likely to see the type of year-over-year growth they were accustomed to seeing in the decade before the recession.
>
> The translation: Institutions have more liabilities, higher debt service and increasing expense without the revenue or the cash reserves to back them up.
>
> In the past, colleges and universities tackled this problem by passing on additional costs to students and their families, or by getting more support from state and federal sources. Because those parties had the ability and the willingness to pay, they did. But the recession has left families with stagnant incomes, substantially reduced home equity, smaller nest eggs and anxiety about job security. Regardless of whether or not families are willing to pay, they are no longer able to foot the ever-increasing bill, and state and federal sources can no longer make up the difference.[25]

Bain's assessment of the reasons for this malaise is what they are calling the "Law of More":

> Much of the liquidity crisis facing higher education comes from having succumbed to the "Law of More." Many institutions have operated on the assumption that the more they build, spend, diversify and expand, the more they will persist and prosper. But instead, the opposite has happened: Institutions have become overleveraged. Their long-term debt is increasing at an average rate of approximately 12% per year, and their average annual interest expense is growing at almost twice the rate of

> their instruction-related expense. In addition to growing debt, administrative and student services costs are growing faster than instructional costs. And fixed costs and overhead consume a growing share of the pie.[26]

A fair number of schools have looked at this approach and wondered about the information on www.thesustainableuniversity.com regarding schools that are in trouble and those that seem “sustainable.” Many schools are scratching their heads about the analysis and wondering why they ended up where they did on this spectrum. Many question the conclusions Bain reached after assessing just two ratios.

This perception issue also surfaced on the front page of the September/October issue of *Trusteeship Magazine*, the trade publication for trustees of colleges and universities. In an article titled “Difficult Days for Higher Ed: Is it Time to Short the Sector?” a panel of experts discussed the issue of financial health and change management. In this exchange Richard Chait, Professor Emeritus at Harvard Graduate School of Education and trustee emeritus at Wheaton College, notes, “American higher education is indeed the envy of the world. In worldwide rankings, we hold eight of the top ten spots.” Continuing his discussion of the longevity and durability of higher education, Dr. Chait points out that many of our higher education institutions are over 150 years old:

> They have been through civil wars, the Great Depression, the student unrest of the 60’s, the hyperinflation of the 70’s, numerous demographic shifts, and the recent explosion in technology. Still, with few exceptions, I cannot think of a notable college or university that has closed its doors, but I can think of scores of iconic American companies that have had to shut down: Bethlehem Steel, Lehman Brothers, Pan Am, Digital Equipment, Circuit City, Borders. So here is the riddle: with all our faults, how do you explain our quality and durability?”[27]

Is the outlook indeed dismal, as Moody’s and Bain would say? Or should college and university leaders have more confidence in their ability to weather this admittedly challenging time? The takeaways summarized by Dr. Chait are outstanding:

1. Frontload governance and devote a lot more time to deciding what to decide.
2. Boards should be much more self-subversive, asking hard questions and making counter arguments. Face the reality that you might be mistaken.
3. Get the questions right.
4. Govern in good humor. Hard times are no time to be glum.[28]

Out-of-Control Costs

In addition to the perception of a dismal outlook for higher education, many believe costs are out of control. Industry insiders like Hill, however, say that:

> …in reality, while costs may be increasing the reasons for those increases have little to do with out of control budgets. Campuses today are more accessible, have accommodations for those with learning differences and a variety of other mental health issues and generally are more accepting, gracious places to be. Much of that has been demanded by our culture, but there is a price to pay for that flexibility.[29]

And is there any argument about the additional costs brought about by the growing burden of regulation?

CapinCrouse Action Items

1. Liquidity is an issue that deserves attention. A focus on liquidity assessment and policy will particularly assist schools in establishing priorities.
2. Cost control can only go so far. Many have come near the end of the road on cost cutting. More strategic tasks are the likely next source for right-sizing the institution. Those tasks include:
    - A plan to evaluate departments and reprioritize budget allocation (necessary on many campuses). Robert C. Dickeson’s *Prioritizing Academic Programs and Services: Reallocating Resources to Achieve Strategic Balance* is a good resource for this.[30]
    - A hard look at available outsourcing and partnership/joint venture opportunities.

REGULATORY GIANTS

The latest round of mistruths about the impact of federal regulation and its intended cost control is ground zero for the longstanding debate on the role and effectiveness of the federal government in improvement to the higher education community.

The White House’s recently announced plan to improve higher education and control its costs is evidence of the political process getting in the way of actual improvement to higher education. President Obama floated the latest proposal in an August 2013 speech at the University at Buffalo. In this speech, the President challenged the Department of Education to develop a rating system for colleges that takes the following factors into consideration:

- Affordability – This factor includes the average tuition charged, availability of scholarships, and the level of student loan debt.
- Access – This factor includes measures of how well the institution provides access to education to students from disadvantaged backgrounds.
- Outcomes – This factor includes graduation rates, earning potential of graduates, and the number of advanced degrees pursued by graduates.

Under this plan, students attending institutions with higher scores could obtain larger Pell Grants and more affordable loans. The negative reactions have apparently surprised administration officials and their colleagues. In an article in *The Chronicle of Higher Education* covering a conversation about the pros and cons of the plan, Katherine Mangan writes that as higher education industry executives "recited a litany of complaints about the data the government uses to measure completion and the dangers of lumping together colleges with different missions," Zakiya Smith, strategy director for Lumina Foundation and former senior advisor for education at the White House's Domestic Policy Council, "was bristling… [Smith] said she was surprised at the extent of opposition to a rating system that doesn't exist yet," Mangan reports. The article quotes Smith as saying "It's is a good thing that the administration is seeking input from the higher-education community."[31]

Many are weighing in on this proposal. David H. Feldman, chair of the economics department at the College of William & Mary, is quoted as saying, "You have to think about the consequences of your shame list. They have to be really careful that they don't provide perverse incentives for schools to discriminate against the kinds of students" they are trying to help.[32] This fear is shared by others, including Gloria Nemerowicz, president of the Yes We Must Coalition. The coalition represents 33 small private colleges at which at least 50% of the students are eligible for Pell Grants. Nemerowicz is concerned about the fairness of penalizing colleges like the ones in her coalition that graduate many students in the fields of social work, teaching, art, and other careers that do not pay well. She said in an interview, "That's not their fault, that's the social order."[33]

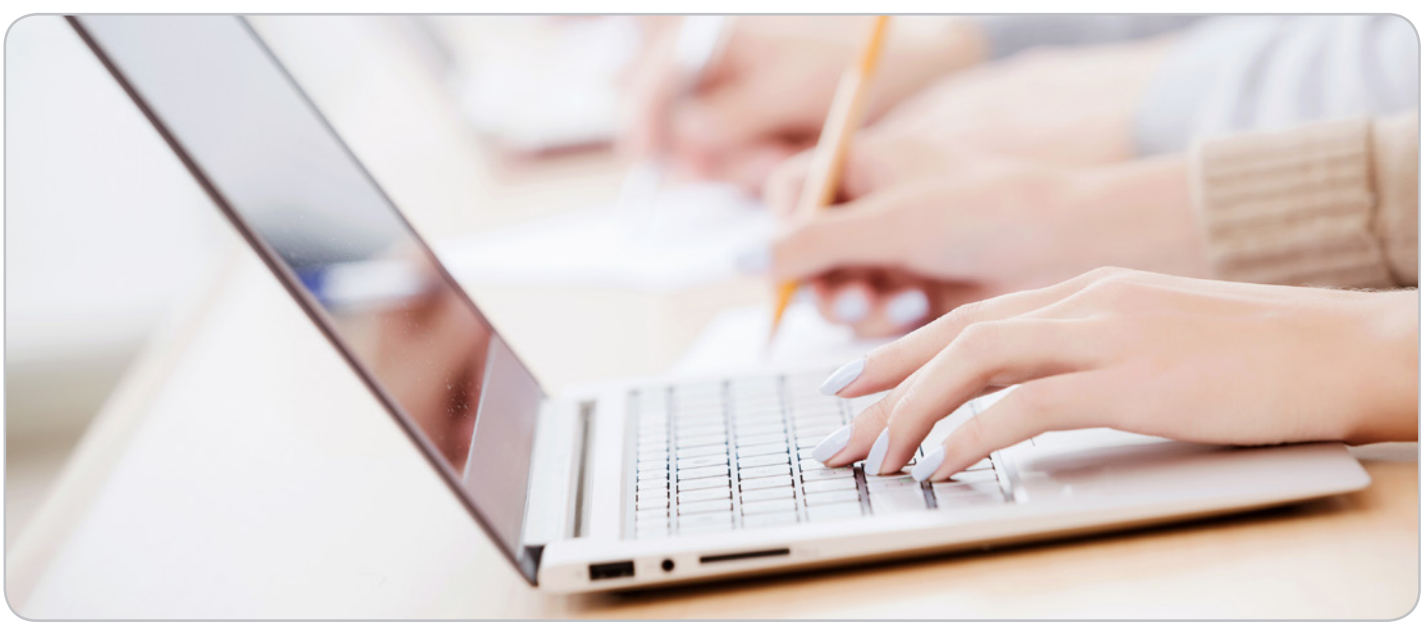
Further, Patricia McGuire, president of Trinity Washington University, notes what she called several "big lies" related to the new proposals:

1. **Federal regulation will reduce college costs** – President McGuire argues that "Each new regulatory foray winds up requiring more staff, more legal fees, more insurance, more training expenses, often more software and more equipment, to say nothing of the opportunity cost of more time spent away from the core enterprise of education."

2. **More data will lead student consumers to make wiser choices** – In 25 years of service as a college president, McGuire says, "I can vouch for the fact that in almost every single one of those years there's been a major federal initiative to make more data available in more compelling ways to college-bound students and their parents." She continues by discussing the school choice decision process in most families by saying, "Guess what? Students still choose colleges based on where their friends go to school. Or where the frat parties are rumored to be spectacular. Or where the football culture is awesome. Or where mom and dad went to school."

   The White House's argument is that "Datapalooza," as they call it, would enable institutional comparison on debt levels, graduation rates, and graduate earnings. The problem is that some of this data is either very limited (earnings is only limited to students receiving federal aid), or nonexistent. One thing is sure, though: capturing more data and crunching more numbers will be an expensive proposition on most campuses. So cost control is apparently not embedded in this idea at all.

3. **More federal involvement with higher education will make higher education better** – McGuire points out the difficulty in lumping together an entire diverse industry like higher education. Swinging the sledgehammer of federal regulation against such a diverse group is sure to have only limited positive results. But it is sure to damage the small schools that many times support marginalized populations with little to no public awareness or accolades. Many of these schools



valiantly fight a daily struggle to do more and be better for their students.

McGuire argues that “If all of higher education — really a vast collection of many industries loosely grouped together in the term “higher education” — can be reduced to a few data points crunched and spewed forth from the Datapalooza machine, then we have truly lost one of the greatest of all American assets, our intellectual capital housed in the nation’s colleges and universities.”[34]

Regulatory Impact on Human Resources

Human resources is one of the largest components of the higher education enterprise. Regulations affecting this area tend to have an exponential impact on the costs associated with operating an institution of higher education. The latest *Inside Higher Ed* poll of chief human resources officers, conducted by the Gallup organization, produced the following key points — many of which are impacted directly or indirectly by regulations. Selected main points of the study are excerpted below:

- Over one-third of chief HR officers (38 percent) say they are very concerned about growing health care costs for retirees.
- About half of chief HR officers (48 percent) say their institution has placed or enforced limits on adjunct faculty hours to avoid having to meet new federal requirements for employer-provided health insurance.
- Just over one-third (38 percent) of chief HR officers say their institution should offer health care benefits for adjunct faculty members.
- Just one in four (24 percent) HR administrators strongly agrees their institution fairly compensates adjunct faculty.
- A majority of officers (62 percent) say their institution is paying more attention to implementing performance evaluation measures than they have in recent years.
- Just 5 percent of chief HR officers strongly agree their institution effectively uses the data and information it has on employee performance and satisfaction to make strategic planning and policy decisions.
- More public sector than private sector institutions offer on-campus child care services for employees.
- Eighty percent of chief human resources officers say firearms should be banned from all college campuses; most (91 percent) say firearms are not permitted on their campus.
- About nine in 10 officers (88 percent) say their institution has a nondiscrimination policy regarding sexual orientation.[35]

CapinCrouse Action Items

1. Take extra steps to understand your marketplace and your unique niche. Be great at what you do best and leverage brand strength through purposeful internal reallocation of resources.
2. Explore alternative enrollment populations that may be in synch with your mission.
3. Be positive about your institution with anyone who will listen in order to counter national media reports about private colleges. Tell your local media outlets about your efforts to change the lives of students. Most colleges are trusted and known in their local markets.
4. Let your constituencies know about your many cost-saving measures and the impact of the real drivers of increased cost… federal mandates like health care

and increased "cost control and quality improvement" regulation.

5. Be watchful and proactive in discussing this latest set of proposals with your advocacy organizations and other influencers. Implementing this rating system proposal will require legislation to become law.

ACCOUNTING UPDATE

This year's batch of accounting updates is a mix of simple changes, updates to issues that have been debated for many years (leases), and a couple of developing reporting trends to watch for.

ACCOUNTING STANDARDS UPDATES

There were numerous accounting standards updates this year, but only a few of them will impact higher education to a great degree. As of October 15, 2013, the Financial Accounting Standards Board (FASB) website showed 11 standards issued in 2013. One more was posted in 2012, but is effective for fiscal years beginning after June 15, 2013 (fiscal 2014).

The Updates that are most interesting to private colleges are one issued in the previous year on cash flow statement classification of donated securities (2012-05); one on the scope clarification for fair value disclosures (2013-03); and the Update on the Services Received for Personnel of an Affiliate (2013-06).

Update 2012-05 Statement of Cash Flows (Topic 230): Not-for-Profit Entities: Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows

This statement was issued as a result of significant diversity in practice. Many schools classify the proceeds from the sale of donated securities as investing cash flows. This is misleading because most of the time, the sale of these assets occurs shortly after receiving them, so no real investing strategies are put into play. We believe that considering the cash from the sales of these securities as operating cash inflows (except when there are restrictions on the use of the proceeds, like endowment or plant and equipment) is more accurate. The following flowchart (Figure 7) highlights the three possible classifications for this cash flow depending on the circumstances, as stated in the Update.

To summarize the flowchart, if donated securities are not sold nearly immediately upon receipt, when eventually sold the cash flows should be classified as investing cash flows. When the securities are sold immediately but there is a restriction on the use of the proceeds for long-term purposes, such as a capital project or endowment, the cash flows should be reported as financing. Most of the time, the securities are sold nearly immediately and the cash flows are then classified as operating cash inflows. This Update is effective for fiscal years beginning after June 15, 2013.[36]

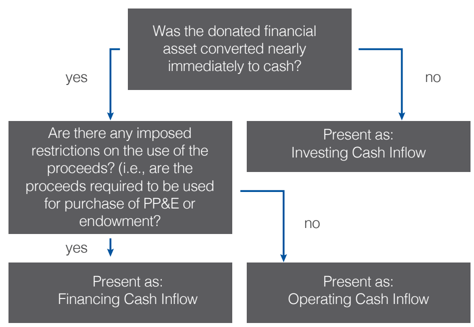
FIGURE 6

FASB Accounting Standard Updates - 2013

Number	Title
2013-01	Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities
2013-02	Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income
2013-03	Financial Instruments (Topic 825): Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities
2013-04	Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date
2013-05	Foreign Currency Matters (Topic 830): Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity
2013-06	Not-for-Profit Entities (Topic 958): Services Received from Personnel of an Affiliate
2013-07	Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting
2013-08	Financial Services—Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements
2013-09	Fair Value Measurement (Topic 820): Deferral of the Effective Date of Certain Disclosures for Nonpublic Employee Benefit Plans in Update No. 2011-04
2013-10	Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes
2013-11	Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists

Source: Financial Accounting Standards Board

FIGURE 7



Update 2013-03 Financial Instruments (Topic 825): Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities

This statement was necessary to clarify the requirements of another Update (2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSS). That Update required a fair value hierarchy disclosure for items that are not measured at fair value in the statement of financial position but for which fair value is disclosed. An example of this would be debt that is on the balance sheet at amortized cost. In certain circumstances the original Update suggested that nonpublic entities that have total assets over $100 million or have one or more derivatives (like interest rate swaps) would not qualify for the exception to the additional disclosure requirement. This Update clarifies that *all* nonpublic entities are exempt from this disclosure requirement.

While the relief from the disclosure was appreciated, the FASB still left a hole in the exception as it failed to exempt *all* not-for-profit entities. Under the existing definitions, this leaves certain higher education entities subject to this disclosure requirement.

The Codification Master Glossary defines a "nonpublic entity" as follows:

> Any entity that does not meet any of the following conditions:
>
> a. Its debt or equity securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally.
>
> b. It is a conduit bond obligor for conduit debt securities that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets).
>
> c. It files with a regulatory agency in preparation for the sale of any class of debt or equity securities in a public market.
>
> d. It is controlled by an entity covered by the preceding criteria.

Therefore, any college or university meeting the conditions above, such as one with conduit debt or one that files with a regulatory agency, is still subject to this disclosure requirement.

This is an example where the current standards have failed to bring consistent principles to bear on nearly comparable entities. The mere fact that one university has a private placement for its debt versus one that has a bond debt issuance that was sold to the public would yield very different disclosure requirements, as one would be considered a public entity (publicly traded bond issue) and one would be considered a nonpublic entity. This topic has been discussed by the Non Profit Advisory Council with the FASB. As part of those discussions, the Board is now proposing to move away from these "bright line" tests for distinguishing public and nonpublic entities going forward.[37]

Update 2013-06 Not-for-Profit Entities (Topic 958): Services Received from Personnel of an Affiliate

In summarizing the FASB document, the Update states:

> The amendments in this Update require a recipient not-for-profit entity to recognize all services received from personnel of an affiliate that directly benefit the recipient not-for-profit entity. Those services should be measured at the cost recognized by the affiliate for the personnel providing those services. However, if measuring a service received from personnel of an affiliate at cost will significantly overstate or understate the value of the service received, the recipient not-for-profit entity may elect to recognize that service received at either (1) the cost recognized by the affiliate for the personnel providing that service or (2) the fair value of that service.[38]

For most recipient not-for-profit entities (other than health care entities required to disclose a performance measure), this Update does not prescribe presentation guidance for the increase in net assets associated with services received from personnel of an affiliate, other than prohibiting reporting as a contra-expense or a contra-asset. All recipient not-for-profit entities should report the corresponding decrease in net assets or the creation or enhancement of an asset resulting from the use of services received from personnel of an affiliate, similar to how other such expenses or assets are reported. The amendments also specify that Subtopic 850-10, Related Party Disclosures—Overall, applies to services received from personnel of an affiliate.

The Update continues:

> This Update does not prescribe the manner of capturing information necessary to apply the amendments in this Update. Any reasonable and verifiable manner of capturing or estimating the information necessary to apply the amendments could be considered, and, in many cases, much of the information could be captured by the recipient not-for-profit entity, which would alleviate the burden on the affiliate that provides the personnel who perform the services.[39]

It is interesting to note that the previous guidance required reporting contributed services consistent with SFAS 116 at fair value of the services given. With this Update, the contributed skilled services criteria and reporting at fair value will no longer apply, so all contributed services from an affiliate should be reported at their cost.

KEY FASB PROJECTS

LEASES

With a final standard to be finally issued in 2014, this project continues to generate feedback. The following timeline provides background on this long-awaited pronouncement.

Lease Accounting History

Early History

1976	SFAS 13 issued, describing leases and mandating two types of lease accounting (Operating and Capital)
1996	Special reports urging a new approach and citing problems with transparency, among other issues
2006	FASB and International Accounting Standards Board (IASB) take up joint project to revise lease accounting
2007 - 2012	Numerous Summary Reports issued on research and opinions gathered

Recent Activity

2010	Exposure draft issued
2010 - 2013	Board and public meetings to consider alternatives and discuss issues

The Final Stretch

9/13/2013	Final comment period ended
10/31/2013	Outreach to various constituencies
Q4 2013	Final redeliberation
TBD 2014	Final issuance of new standard

The latest major feedback was in the form of two letters issued at the comment deadline by the American Institute of Certified Public Accountants (AICPA) and the National Association of College and University Business Officers (NACUBO).

While these two groups generally agree with the basic objective of the new standard — to record almost all leases on the balance sheet of lessees as an obligation and a right of use asset — they remain concerned that the other important objectives have not been met. In fact, the letter from the AICPA Financial Reporting Executive Committee (FinREC) went so far as to say that this new standard is not a sufficient enough improvement over today's guidance to support adoption of the proposals in the exposure draft.

The FinREC letter points out that there were three criticisms of current lease accounting standards (excerpted below):

1. Many leases are off-balance sheet despite the fact that financial statement users believe that they give rise to assets and liabilities that should be recognized in the financial statements of lessees. This forces users to adjust the reported amounts in the financial statements in connection with those transactions.

2. The existence of two very different accounting models for leases means that similar transactions can be accounted for very differently, which reduces comparability for users.

3. Existing lease accounting standards provide transaction structuring opportunities that make the financial statements less transparent for users.[40]

The latest exposure draft appears to deal adequately with the first criticism by putting the commitment for lease payments on the balance sheet. However, as the FinREC points out in its letter, "the ED's [exposure draft's] proposals do not resolve the second and third criticisms of current lease accounting standards identified by the boards."[41]

Meanwhile, the NACUBO letter raises numerous concerns, including the following excerpted from the letter:

- Some colleges and universities are lessors with long-term land leases. The proposed guidance could cause the leased land to be classified in a way that de-recognizes the asset over the term of the lease—as if it had been sold. Such a presentation would not properly reflect economic reality, ownership, or the institution's financial position.

- Although both boards recognize that some lessors enter into leases for investment purposes, FASB does not acknowledge that fair value measurement of an asset leased for investment is acceptable for not-for-profit entities such as higher education institutions.

- Not all colleges and universities can easily determine the appropriate discount rate to use in the measurement calculation. As a result, smaller colleges may need to use a risk-free rate, which will result in a greater asset and liability. Larger assets and liabilities may impact debt covenants or other calculations based on financial ratios.

- Using two methods for expense recognition will not result in greater transparency for users. In fact, it is likely to do just the opposite. Using a straight-line method for one type of lease and an amortization method for another obscures the total lease income/expense on the statements of activities and cash flows.

- Separating lease expense into amortization and interest expense rather than showing it all as lease expense will create issues for research institutions that are subject to Office of Management and Budget (OMB) compliance requirements.

- The proposed "right to use" asset and related liability will create issues for NFP institutions that are subject to Department of Education financial responsibility requirements.

- An effective date or an implementation time line has not been proposed. Because colleges and universities are subject to federal regulations monitored by various federal agencies, significant lead time will be needed to allow for regulatory change.[42]

Will the latest exposure draft be pushed through in the face of this significant negative feedback? Only time will tell.

NOT-FOR-PROFIT REPORTING INITIATIVE

This initiative is a combination of two separate FASB projects. One is a FASB Standard project titled Not-for-Profit Financial Reporting: Financial Statements. This document will be exposed to examine existing standards for financial statement presentation for not-for-profit organizations, with a focus on net asset classification requirements and other information provided in financial statements regarding liquidity, financial performance, and cash flows.

The second is a research project titled Not-for-Profit Financial Reporting: Other Financial Communications. The objective of this study is to gather information about how not-for-profit organizations tell their financial story. The FASB staff plans to review existing best practices to discern how these additional communications improve the understanding of key users of the financial data, such as donors, creditors, and other stakeholders, through communications about the organization's performance and its overall financial health.

Financial Statement Project

The key feature of this project is the redefinition of, and required display for, net assets. Currently, three classes of net assets are required to be displayed: Unrestricted, Temporarily Restricted, and Permanently Restricted. The tentative decision is to replace the three-category requirement with a two-category requirement: net assets with donor-imposed restrictions, and net assets without donor-imposed restrictions.

One of the difficulties discussed is the fact that many people confuse "unrestricted" with available or liquid, or both. Clearly, there are currently several components of unrestricted, the largest of which is the net investment in buildings and equipment. In higher education institutions, this is normally a very significant number. When that is lumped with other unrestricted net asset balances, it sometimes is assumed that there is plenty of liquidity and financial flexibility in the organization. The truth, however, is that in many cases, amounts of net assets tied up in equity in property and equipment can be the majority of the unrestricted funds. This leaves the college or university with little to no flexibility. Unless the net assets tied up in buildings (net of debt) is disclosed separately, there is little chance that a casual reader of the statements — which could include some board members — will properly interpret the amount of liquidity or financial flexibility, and may even be misled by such a display.

In addition to the potential for misinterpreting the liquidity of the college by using "unrestricted net assets" as a proxy, there is an equally significant interpretation error that can be made with permanently restricted resources. Since the implementation of the new Uniform Prudent Management of Institutional Funds Act (UPMIFA) in every state except Pennsylvania, there is now some flexibility within the boundaries of "prudence" in the amounts currently carried as "permanently" restricted. Most endowment balances include the total of temporarily restricted net assets amounts (the amount above the historical gift) and permanently restricted (the original gift plus corpus additions). The new UPMIFA law would allow inclusion of original gift amounts if deemed prudent. This will be tested by case law, of course. There has not been much activity under the new law at this point in the evolution of the new legal construct. So from an accounting perspective, what we call "permanent" is really no longer fully permanent.

The disclosures for the new two-stage presentation of net assets may feature disclosure of the nature and amounts of different types of donor restrictions. It may also include the purpose and amounts of board-designated net assets (without donor-imposed restrictions). The presentation may look like the following:

FIGURE 8

Net Assets	**201x**
Without donor restrictions:	
Available for use	$785
Net investment in PP&E	$655
Board designation:	
Capital projects	$50
Operating reserves	$25
Quasi-endowment	$1,100
Total net assets without donor restrictions	**$2,615**
With donor restrictions:	
Purpose restrictions:	
Program A	$55
Program B	$123
Program C	
Time restrictions:	
Less than 12 months	$325
12 months and beyond	$617
Endowment fund	$1,550
Total net assets with donor restrictions	**$2,670**

In addition to the new net asset display and disclosure, several other topics will be considered as the deliberations move forward. These topics include:

- Financial performance and the notion of including an operating measure in the statement of activities, or perhaps using a two-statement approach

- Liquidity information disclosure

- Cash Flow Statement

- Other potential statements or schedules, such as the statement of functional expenses

- Footnote disclosure improvements

The FASB board reached a tentative decision about the definition of an intermediate operating measure at its May 29, 2013, meeting. The definition is based on two separate dimensions:

1. A **mission dimension** based on whether the resources are from or directed at carrying out a not-for-profit entity's purpose for existence, and

2. An **availability dimension** based on whether resources are available for current period activities, and reflecting both external limitations and internal actions of a not-for-profit entity's governing board. For example, restricted gifts for use in future periods are outside the definition of "current period intermediate operating measure."

While the board has reached a tentative decision on definitions, it has not yet reached a decision on making the disclosure required or optional.

Since this is a deliberate process in which it can take months to prepare next steps, it will be a while before a complete statement can be issued. The current plan is for a 2014 exposure draft and a 2015 final issuance after extensive outreach, field visits, workshops, roundtables, and board redeliberation.

Research Project

The research project will focus on what is known as "Other Financial Communications (MD&A)." Readers of public company financial statements know this information well. It is found at the beginning of annual reports and includes summary information about the company, its performance, and its future plans. College and university engagement with these types of disclosures is varied, but more seem to be embracing the idea. While there is engagement with the topic, however, quality varies and consistency is lacking, especially around forward-looking and liquidity information. It is clear that a framework for this type of disclosure is needed.

The board plans to issue an Invitation to Comment concurrently with the exposure draft of the financial statement project in early 2014. The feedback from the invitation to comment should help the FASB decide if it will add this to a standard-setting project.

DISCLOSURE FRAMEWORK

The FASB issued an Invitation to Comment, titled "Disclosure Framework," to ask for input on ways to improve the effectiveness of disclosures in notes to the financial statements of public, private, and not-for-profit organizations.

This is the first step as the FASB works to collect input on ways to improve disclosure effectiveness. The Invitation to Comment addresses the following topics, which are organized around two separate categories.

FASB-related items:

1. A decision process that could aid the board in establishing disclosure requirements that address relevant information, and only relevant information.

2. Flexible disclosure requirements that could be adapted by each reporting organization to focus on information that is relevant in its specific circumstances.

Entity-related items:

3. A judgment framework that could help each reporting organization determine which disclosures are relevant in its specific circumstances.

4. Organization and formatting techniques that could make the information users need easier to find and understand.

Rather than recommending specific changes, the paper outlines possibilities that the FASB feels could result in more effective disclosures from reporting organizations. "The Board believes that establishing a framework for disclosure is an important first step before any specific changes to existing disclosure requirements are considered," the FASB reported in a news release, adding that it plans to apply that framework to existing standards as well. "Applying the framework to existing standards could eventually result in modifying existing requirements or establishing new ones; any such changes would be exposed for public comment," the release notes.[43]

The release includes a statement from FASB chairman Leslie F. Seidman:

> Many stakeholders have expressed concerns about the relevance and sheer volume of information in notes to financial statements, and that some information is either missing or difficult to find… Therefore, the FASB is looking to improve its own procedures for establishing disclosure requirements and to provide a way for reporting organizations to exercise judgment about which disclosures are relevant to them. The ultimate goal is to enhance users' abilities to analyze the information in the notes to financial statements while minimizing the burden on reporting organizations.[44]

DEFINITION OF A NONPUBLIC ENTITY

On August 7, 2013, the FASB Board issued an Invitation to Comment on a key definition in the FASB Master Glossary.

The definition of "public entity" versus "private entity" is an important distinction because it impacts certain accounting, reporting, and disclosure requirements.

The FASB Invitation to Comment states:

> The proposed amendments would define a public business entity as a business entity meeting any one of the following criteria:
>
> 1. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements, with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
> 2. It is required by the Securities Exchange Act of 1934, as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency.
> 3. It is required to file or furnish financial statements with a regulatory agency in preparation for the sale of securities or for purposes of issuing securities.
> 4. It has (or is a conduit bond obligor for) unrestricted securities that are traded or can be traded on an exchange or an over-the-counter market.
> 5. Its securities are unrestricted, and it is required to provide U.S. GAAP financial statements to be made publicly available on a periodic basis pursuant to a legal or regulatory requirement.
>
> This excludes an NFP or an employee benefit plan within the scope of Topics 960 through 965 on plan accounting.[45]

Although not-for-profit organizations were not included in the definition of a public entity, the Invitation to Comment noted that "the Board would consider factors such as user needs and NFP resources, on a standard-by-standard basis, when determining whether all, none, or only some NFPs will be eligible to apply accounting and reporting alternatives within U.S. GAAP for private companies."[46]

REVENUE RECOGNITION

Currently, there are numerous standards with specific industry guidance on how to recognize revenue. The primary objective of the revenue recognition standard was to write a single, principle-based standard that would improve the accounting for revenue earned in contracts with customers. During a recent AICPA webcast, McGladrey LLP partner Brian Marshall said, "It's a very lofty goal because what they're looking to do is have a single revenue recognition standard for all industries and entities. Today in U.S. GAAP there is a lot of industry-specific guidance. It's quite a feat to move from that to a single revenue recognition model."[47]

As we reported in the *2013 Higher Education Update*, the standard will require a five-step process for revenue recognition:

1. Identify the contract with the customer
2. Identify any separate performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the various performance obligations
5. Recognize revenue when a performance obligation is satisfied

During the September FASB meetings on this topic, the board continued to discuss how the joint revenue recognition standard will address collectability, the constraint on variable consideration, and the accounting for revenue from licenses of intellectual property. They decided that further discussions are necessary. As a result, the standard was not expected to be issued until late 2013 at the earliest.

While this is going on, it is important to note that many not-for-profit transactions have been scoped out. These transactions include contributions and collaborative arrangements. The higher education industry segment that will be affected the most is universities with health care systems as part of their operations. These entities will most likely struggle with issues like who the customer is in collaborative environments with several partners and collaborators (mostly Research and Development), and collectability and risk of revenue reversal concerns, which are the topics currently being discussed.

So far, the FASB tentatively decided the final standard will likely be effective for annual reporting periods beginning after December 15, 2016, for public entities and after December 15, 2017, for non-public entities, with no early adoption permitted.

FINANCIAL INSTRUMENTS

This topic has a long history, going back to FASB and IASB joint meetings in April and October 2005 at which the FASB and the IASB discussed the future of reporting for financial instruments. At that time the boards established three long-term objectives:

1. Develop a new standard for the derecognition of financial instruments
2. Require all financial instruments to be measured at fair value, with realized and unrealized gains and losses recognized in the period in which they occur
3. Simplify or eliminate the need for special hedge accounting requirements[48]

In March 2006 the boards clarified their intention to work together to improve and converge financial reporting standards. This was accomplished by issuing a Memorandum of Understanding (MoU) titled "A Roadmap for Convergence between IFRSs and US GAAP—2006 – 2008." The joint working group realized that this area of accounting literature was more complex than it should be. This simplification effort resulted in the IASB's issuance of the March 2008 Discussion Paper, "Reducing Complexity in Reporting Financial Instruments," which the FASB also published for comment from its constituents. This Discussion Paper covered the measurement of financial instruments and hedge accounting. It also identified several possible approaches for improving and simplifying the accounting for financial instruments.

At the joint meeting in October 2008, the FASB and IASB created an advisory group, The Financial Crisis Advisory Group (FCAG). This work was being done in the midst of the global credit crisis that was brought to us in some degree by new transactions known as derivatives. The FCAG was asked to identify accounting issues that required the boards' urgent and immediate attention due to the existing crisis, as well as issues for longer-term consideration.

In addition to considering the potential for short-term responses to the credit crisis, both boards emphasized their commitment to developing common solutions to provide transparency and reduce the complexity found in the existing literature.

The recent discussions on this topic are divided into three sections:

1. Classification and Measurement
2. Hedge Accounting
3. Credit Impairment

The key impact for colleges and universities related to the classification and measurement section includes the following items:

1. Pledges receivable have been scoped out
2. Most loans receivable (student loans, etc.) and liabilities will remain at amortized cost
3. Nonmarketable equity securities like private equity funds can follow a practical expedient (cost adjusted for observable transactions)
4. No more "FAS 107" disclosures for nonpublic colleges and universities regardless of size (assets over $1 million) and the presence of derivatives (interest rate swaps)

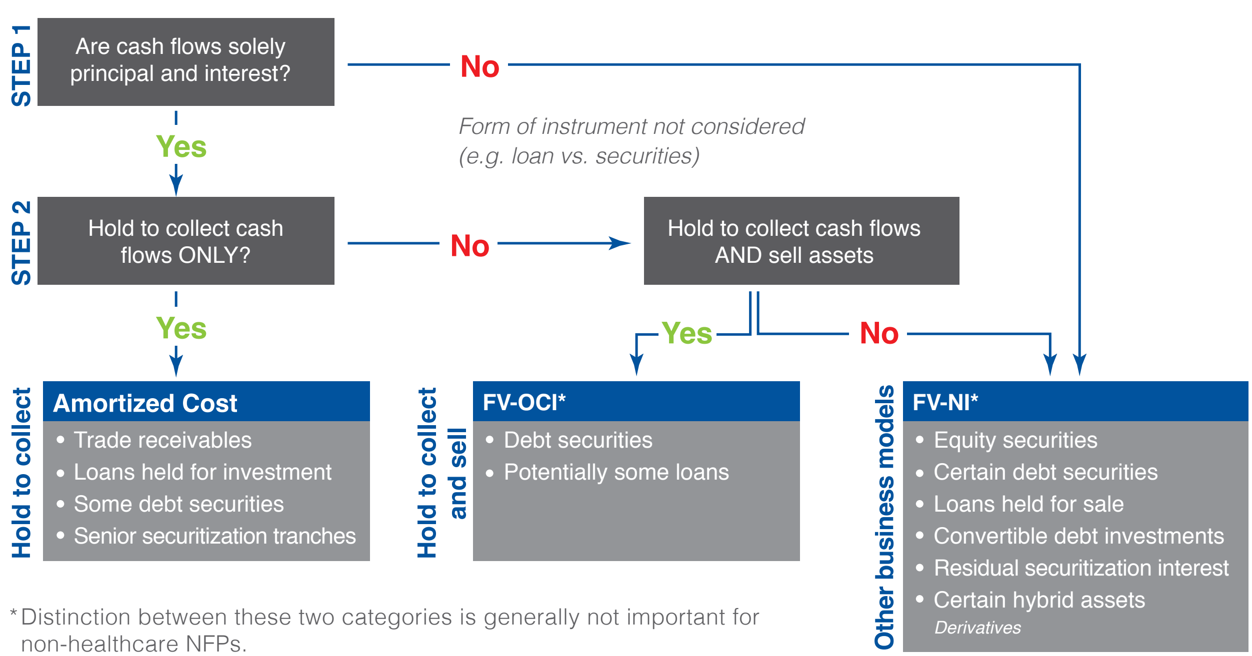
Figure 9 helps describe the processes for deciding between amortized cost or fair value accounting.

The credit impairment section of this work proposes a new model for recognizing credit losses called the Current Expected Credit Losses Model (CECL). Under this model, expected credit losses would be re-estimated, with favorable and unfavorable changes reported in earnings. The estimates are to be based on current risk ratings, historical loss experience for assets with similar risk ratings, and remaining lives adjusted for changes in current circumstances along with reasonable and supportable expectations about the future.

This model replaces the multiple models that are currently in existing literature, so simplification is present. This new model applies to all "financial assets" subject to credit risk including

FIGURE 9

How Financial Assets are Categorized



*Distinction between these two categories is generally not important for non-healthcare NFPs.

trade and lease receivables, loans, and securities carried at amortized cost.

Remaining issues commented on by the NACUBO Accounting Principles Committee include:

1. Presentation of realized gains and losses in the statement of activities. It is still unclear whether the college that presents a measure of operations would be required to present realized gains and losses in "operations."

2. The requirement to provide fair value information for assets and liabilities carried at amounts other than fair value. It is clear that time and effort involved in determining two sets of values would not have a good cost benefit trade-off.

3. Elimination of the fair value option if pledges are reported as such. According to Susan Mendito, Director of Accounting Policy for NACUBO, there are still a few colleges that use the fair value option for reporting pledges. It was not clear in the latest exposure draft how these institutions would treat promises to give currently valued under the fair value option once the accounting standard update becomes effective.

GOING CONCERN

This accounting standards topic has also been around a while, but the main focus of the standards was part of audit standards managed by auditors, and not accounting standards managed by organizations reporting their financial status. The topic has a long history going back to October 2008, when the board first issued the exposure draft on this topic, Going Concern. The intention was to provide entities with guidance on the preparation of financial statements as a going concern and on management's responsibility to evaluate uncertainties about an entity's ability to continue as a going concern. The 2008 Draft required disclosures either when financial statements were not prepared on a going concern basis, or when there was substantial doubt about an entity's ability to continue as a going concern. The 2008 exposure draft carried forward the going concern guidance from the auditing literature. It was also written to align with IFRS standards.

Respondents to the 2008 exposure draft indicated terminology and thresholds used in the proposed guidance needed further clarification, such as going concern and substantial doubt. Other concerns were also expressed about the proposal, including potential complexities on the indefinite nature of the proposed time horizon and the proposed guidance on evaluating all available information about the future. Respondents also highlighted the apparent omission of the disclosures contained in the auditing literature when an auditor's initial substantial doubt concern is alleviated because of management's plans.

It was clear to many respondents that guidance about when and how to prepare financial statements using the liquidation basis of accounting was needed. As a result, the board decided to address the liquidation basis of accounting as part of a separate project. The board issued Accounting Standards Update No. 2013-07, Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting, in April 2013 to address this need.

Since the issuance of the 2008 exposure draft, the board has reassessed the objective of the going concern project. In 2010, the board modified the objective of the going concern project to propose earlier disclosures about going concern uncertainties. The resulting staff draft was not exposed to the public but was reviewed by a group of users, regulators, and auditors who indicated that the revised guidance may not be operable. In 2011 the board considered but later rejected incorporating going concern uncertainty disclosures in the separate project about liquidity and interest rate risk disclosures. In May 2012 the board decided to proceed with the project on going concern with the objective of providing an entity and its management with guidance on assessing uncertainties about an entity's going concern presumption and related disclosures.

As noted in the June 26, 2013, *FASB In Focus*, the currently proposed model:

> …would provide guidance in U.S. GAAP on management's responsibilities in evaluating an organization's going concern uncertainties and on the timing, nature and extent of related footnote disclosures. An organization would determine the need for disclosures by assessing the likelihood that the organization would be unable to meet its obligations as they become due within 24 months after the financial statement date.[49]

The June 26 *FASB In Focus* goes on to explain:

> Going concern uncertainties would be evaluated at each interim and annual reporting period. The reporting organization would start providing footnote disclosures when it is either (1) more likely than not that the organization will be unable to meet its obligations within 12 months after the financial statement date without taking actions outside of the ordinary course of business, or (2) known or probable that the organization will be unable to meet its obligations within 24 months after the financial statement due date without taking actions outside the ordinary course of business.[50]

CONCLUSION

As in most years, there are a lot of issues and factors impacting higher education. This year's discussions about major changes in the not-for-profit income statement (Measure of Operations) and balance sheet net assets account (three classes down to two) will certainly get a lot of attention and create extra work for some time to come.

We hope the information and input in this white paper will assist you and your campus colleagues in initiating changes before they become urgent priorities.

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