DOCUMENT RESUME

ED 113 994 HE 006 755

AUTHOR	Gilmore, Robert B.
TITLE	Making University Financial Reports Informative and Meaningful.
INSTITUTION	National Association of Coll. and Univ. Business Officers, Washington, D.C.
PUB DATE	Oct 70
NOTE	8p.
AVAILABLE FROM	National Association of College and University Business Officers, One Dupont Circle, Washington, D.C. 20036
JOURNAL CIT	NACUBO Professional File; v1 n5 Oct 1970
EDRS PRICE	MF-$0.76 Plus Postage. HC Not Available from EDRS.
DESCRIPTORS	Accounting; Budgeting; *Educational Finance; Educational Resources; *Financial Policy; Financial Support; *Higher Education; Management; *Operating Expenses; Trusts (Financial)

ABSTRACT

The National Association of College and University Business Officers has taken major strides toward meeting the responsibility for establishing accounting and public reporting standards within the field of higher education. The need for improvement in the reporting procedures has been generally agreed on. It is imperative that revision of the manual for financial reports and an audit guide seek common ground, and to this end the author has suggested some significant areas of controversy for discussion. The first area deals with the nonprofit nature of educational institutions; they cannot be viewed in terms of profit and loss, since they are primarily in the business of spending money as wisely and productively as possible. Secondly, colleges and universities generally approach financial management as an integrated function, dealing with the resources and needs of the total institution over a period of time. A third controversial topic deals with the setting aside of funds to meet anticipated needs and the alternative methods of disclosing these restricted and unrestricted funds. The prime vehicle for disclosure suggested is a separate funds statement to accompany a subsidiary operating statement. (JMF)

VOLUME 1, Number 5 • OCTOBER, 1970

ACCOUNTING

NACUBO

PROFESSIONAL FILE

MAKING UNIVERSITY FINANCIAL REPORTS INFORMATIVE AND MEANINGFUL

By ROBERT B. GILMORE
Vice President for Business and Finance
California Institute of Technology

Serious work is again under way to revise *College and University Business Administration* (American Council on Education: Revised Edition, 1968), a volume recognized as dominantly authoritative in its field. Needed to guide revision of the accounting portion of this manual is the assurance of broadly based agreement on certain issues. This paper, expressing an individual viewpoint, is intended to stimulate discussion of several fundamental aspects of financial disclosure and statement presentation.

That external financial reporting by colleges and universities can be improved will surely be conceded by all who use their reports. The direction of change to accomplish improvement is a more controversial issue. The American Institute of Certified Public Accountants (AICPA) recently appointed a committee to prepare an audit guide for colleges and universities, a committee which now includes two non-voting advisory members from the National Association of College and University Business Officers.

NOTE: The financial statement of the college or university is prepared by the financial staff of the institution as an official report on the institution's resources. The statement is reviewed by independent accountants for conformance with generally accepted accounting principles. The major reference for this purpose to date has been College and University Business Administration, *recognized as the authoritative statement on accounting and reporting, as well as on other business management matters, in the field of higher education. This publication presently is under revision through a NACUBO committee.*

Now, as part of its program to write audit manuals for various industries, the American Institute of Certified Public Accountants has named a committee of CPA's to write such a manual for colleges and universities. The recommendations of this committee can be expected to go before the Accounting Principles Board for public disclosure, evaluation, and possible amendment. Upon official adoption an AICPA manual is intended to become the standard by which the public accounting profession will audit the financial statements of clients. Deviations from standard would require disclaiming exceptions in the auditor's letter of opinion.

Several proposals emerging in the work of the AICPA committee may prove unacceptable to the educational "industry." It behooves all those interested in college and university finance, whether trustees, administrators, or friends of higher education, to become informed on the subject. This paper by Mr. Gilmore, chairman of NACUBO's committee to revise College and University Business Administration *and one of two NACUBO advisory members on the AICPA committee on college and university accounting and auditing, is designed to illuminate the basic issues at stake.*

Early indications are that the committee is approaching its task with vigor and imagination. Representatives of the accounting profession contributed to the work of the 1968 and earlier revisions of *CUBA*, and because the effort of the new AICPA committee assures an active dialogue, the work of revision of *CUBA* certainly will be strengthened and enriched. Should important differences arise, as now seems likely, a wide and thorough airing of the issues and the contrasting rationales becomes especially important.

The Need to Seek Common Ground

It is imperative that revision of the manual and the development of an audit guide seek common ground. Both must recognize that financial statements are the reports of *management* to its constituents and the public, and that, consequently, management bears the primary responsibility for improving reporting standards in published financial reports.

The National Association of College and University Business Officers has taken major strides in the past—and with considerable success—toward meeting the responsibility for establishing accounting and public reporting standards within the field of higher education. This must continue.

PROGRESS TO DATE

In 1922 and 1931 little books[1] of sample financial statements for colleges and universities were published to bring some degree of order out of confusion. Small colleges were accounting and reporting on their financial affairs in a wide variety of ways. Some statements so mixed current operations with endowment and plant transactions that it was impossible to identify nonexpendable funds, let alone their retention, or determine the extent to which noneducational activities were being supported by educational income, whether by intent or accident. The system of fund groups the little books illustrated still is the foundation for today's *College and University Business Administration* and is universally accepted.

There came, in the years immediately following, a series of monographs on various topics of interest to college administrators. Then the 1955 and 1968 editions of *CUBA* brought a surprising degree of uniformity to financial statements across the country, especially to the reports of small colleges. One may complain that the data from one college are not comparable to data from another because the organizational structures, budget categories, and operating procedures are so varied that expenditure classifications have different meanings at different institutions. However, balance sheets and their contents seem to have a fairly high degree of comparability. Overall, it can be said that standards and guidelines—universally followed or not—do exist for accounting and reporting among institutions of higher education.

Even though some of our leading institutions fail to adopt all of them intact, standards nevertheless are recognized. When an outside auditor completes his annual examination and prepares the opinion letter, he presently feels obliged to include exceptions if the institution varies from the standards set out in *CUBA*, and the government, represented by the U.S. Office of Education, certainly accepts these standards for its questionnaires. However, concepts which were acceptable to the majority of institutions represented on the 1968 Revision Committee will be subject to evolution because the factors of change and obsolescence are indeed present. This evolution now receives added impetus from public accountants.

The National Association recognized the constant pressure for change when, promptly after publication in 1968, a committee was appointed to revise *CUBA*. This committee is proceeding toward publication of a series of loose-leaf bulletins to revise chapters in the existing book, hoping in this way to correct the most vulnerable portions first. Various professional groups affiliated with NACUBO are working on the chapters describing

[1] Arnett, Trevor: *College and University Finance*. New York: General Education Board, 1922; *Report of the National Committee on Standard Reports for Institutions of Higher Education*. Lloyd Morey, Chairman; Champaign, Illinois; Flanigan-Pearson Company, 1931.

Robert B. Gilmore, Caltech's Vice President for Business and Finance since 1962, is a native of Iowa, a graduate of U.C.L.A., a CPA in Iowa and California, and a professional whose career has encompassed an exceptionally wide range of activities and services. After early experience as a Haskins & Sells staff accountant, Mr. Gilmore went to Caltech in 1948 as Manager of Accounting Offices, then served as Assistant Comptroller, 1952-1958, and Comptroller, 1958-1962, before being named to his present position. He is a member of AICPA and of the California Society of CPA's. He is a former President of WACUBO and a former member of NACUBO's Committee on Governmental Relations. He was a member of the Editorial Subcommittee for the 1968 revision of College and University Business Administration, *experience which admirably equips him for the responsibilities he now carries in relation to revision of* CUBA *and advisory associations with AICPA.*

Letters of Comment Invited by NACUBO

their respective activities. On the more controversial accounting principles and practices portions, papers are being written to stimulate wider discussion of the issues involved. The revision committee has recommended that anyone with criticisms or suggestions write a letter to the NACUBO office, addressed to Mr. D. F. Finn, Executive Vice President. If a paper for publication is appropriate, the national office is prepared to offer assistance, including national distribution to those interested, and to serve as clearing house for feedback.

At this point we should establish a frame of reference for the recommendations that follow by discussion of (1) concepts related to nonprofit objectives, (2) the integrated approach used in planning and financing future activities, and (3) the ongoing financial implications of the activities of institutions of higher education. These factors should all be reflected by financial reporting.

FIRST, THE NONPROFIT NATURE OF EDUCATIONAL INSTITUTIONS

A fair measure of "net earnings per share" is the end-product of industrial accounting principles and most public accounting practice. Accountants have been educated for industrial or commercial enterprise, and if fund accounting for nonprofit institutions was studied at all, it was looked upon as an interesting variation. As a result, accountants, the author included, have a bias, even a compulsion, to determine the university profit or loss each year. Is the concept of net gain or loss really applicable to a college or university?

Expenditures Evidence the Products of Higher Education

In industrial accounting, one begins with the main function of the firm, sales of the product of the entity, and determines the costs which logically can be related to the particular sales during the year under consideration. The difference is profit or loss. In contrast, colleges and universities are primarily in the business of spending money as wisely and productively as possible. They are nonprofit entities, striving to give the most in instruction and research for each dollar available. Revenues must be related to the particular product during the year. However, when their activities are reported in the traditional statement of current funds revenues and expenditures, the bottom figure cannot help but be interpreted as the year's profit or loss—profits evidencing wealth and losses indicating living beyond one's means. The statement format invites a snap conclusion—an instant, simplistic judgment. In many cases the snap conclusion is valid; in other cases the reader of the statement draws an erroneous conclusion. This problem is pursued elsewhere in this paper.

There is evidence of favor among some public accountants for an all-inclusive statement of current funds revenues, expenditures, transfers, allocations and balances. This statement would include as current revenues all unrestricted receipts for the year, regardless of any requirement or intention that they be spent. Transfers of current funds to other fund groups would appear below the augmented "net income" figure. The so-called alternative method (discussed further below) by which unrestricted gifts may be carried forward if not used, rather than considered revenue of the current year, would be abolished. The motive apparently is the design of a fool-proof method by which to determine the extent to which an institution is currently expending all unrestricted cash inflow. Such a statement isolates current funds changes from changes in other funds and precludes a consolidated funds statement. This concept results from a preoccupation with "net earnings" in the commercial accounting sense. There are ways to improve disclosure without fragmenting the statement of changes in fund balances.

SECOND, THE INTEGRATED APPROACH

Major Tasks Demand Integrated Planning.

Universities, in spite of their diversity and internal decentralization, in most cases approach financial management as an integrated function, dealing with the resources and needs of the total institution. The planning for the long term and for the next year's budget considers building expansion and rehabilitation, student support, and endowment strategy to provide ongoing support for faculty tenure obligations, not just the annual cash flow in and out for strictly operating purposes.

The high priority objectives, based on academic goals, can only be implemented in an integrated, institution-wide program. The total expected inflow of funds for the next several years is estimated and considered together with usable funds on hand. Together these form the basis for establishing an integrated plan for the outlay of certain funds, some existing and some anticipated, some unrestricted, but the major portion limited in some degree for endowment, plant, or loan fund use. Current funds revenues and expenditures, while important, are only part of the year's financial operations. Our financial reporting of resources and their management should be on the basis of the whole institution, too. Again, total emphasis upon "net operating results" can defeat an adequate disclosure.

THIRD, SETTING FUNDS ASIDE TO MEET ANTICIPATED NEEDS

Another topic on which we find controversy and questions with respect to reporting is the matter of the accounting treatment of gift funds under internal decision defining the use more narrowly than the terms of the gift. When considering the problems of gift reporting, one must be aware that the dividing line between unrestricted and restricted gifts is hazy, especially as to extraordinary foundation grants or bequests which by implication are destined for capital use rather than support of current operations. The so-called "alternate method," discussed below, offers disclosure much preferable to defining extraordinary broad grants as "restricted."

Trustees' Responsibilities Go Beyond Current Year And Its Operations

Just as in industry accountants assume the business is a going concern, in higher education the fixed commitments into the future for tenured faculty and ongoing programs are recognized and funds are husbanded for gradual use on the future years' expenditures. To mandate, for all institutions under all circumstances, that the full amounts of broad, major grants immediately be drawn down to zero as operating revenues, runs counter to sound management and to fair stewardship reporting. Financial reporting can be more in tune with the going concern and the prospect of a long and productive life.

The donor of an unrestricted gift, in giving the trustees complete discretion as to use, no doubt recognized that a capital-type use was possible, even likely if the gift was a bequest or a memorial contribution. To assume that all unrestricted gifts are, per se, for current purposes is unrealistic. Further, the funds set aside for future, specific use are not necessarily unrestricted gifts and bequests; they may have been restricted by the donor within a broad field.

This internal designation procedure is sound financially, and is completely within the powers of the trustees, but the results need disclosure. Only in the 1968 revision of *CUBA* was disclosure first discussed, even though "designated funds" have been with us through the years, well mingled with restricted funds. When a substantial bequest became the good fortune of an institution, it very likely appeared as an addition to plant or endowment funds. "Transfers" also occurred. While institutions supposedly were reporting all unrestricted revenues in the year of receipt, the large gifts were bypassing the operating statement and defied detection on any report. Any public accountant might have found a basis for challenging such treatment of an unrestricted bequest. I have the impression that the public accounting profession was looking the other way, just as were college accountants.

Results of Designation Must Be Disclosed

The 1968 revision undertakes to regularize reporting of unrestricted gifts by mandating either the standard method or the alternate method. If the institution elects not to show *all* unrestricted gifts on the Operating Statement (standard method), it can elect the alternate method and disclose the total of such gifts on the Funds Statement, then show transfers from Current Funds Unrestricted to other fund groups, and to current revenues as gifts applied. Note: The remaining funds are still in evidence as unspent balances — nothing is hidden!

The indications referred to earlier, that some public accountants wish to abolish the alternative method of reporting unrestricted gifts, have profound implications. Institutions would be required to report as income in the year received all unrestricted funds which the governing board decides to allocate to quasi-endowment, plant, loan funds, or for specific expenditure at a later date. Furthermore, there are indications that any subsequent realized gain and investment income earned thereon after allocation would be required to be reported as unrestricted revenue in the year earned. The practical implications alone are staggering. Traditionally, these funds which were designated for a specific purpose have been accounted for in the same manner as similar restricted funds which were established by outside donors, and usually with gains and income earned on invested balances added to those fund balances. A brief examination of the nature of a "fund" may explain the concept from which this practice follows.

A university has no owners; instead, the basic unit of interest which incurs liabilities, manages assets, and carries on operations, is the "fund." As defined by the National Committee on Governmental Accounting, a fund is a "sum of money or other resources segregated for the purposes of carrying on specific activities or obtaining certain objectives in accordance with special regulations, restrictions, and limitations." Each fund is accounted for separately using double entry bookkeeping, and is capable of having drawn off for it an operating statement, fund statement, and balance sheet for each fiscal period — even though this is seldom done. The university records also permit the cumulation of totals of the various categories of like assets, liabilities, income and expense for each fund group and for the consolidated funds of the university as a whole. However, the fund in all its various components — income, capital gains, and principal — stays a cohesive entity directed toward specific goals. As the goals are attained, the funds are reported as applied. Otherwise, how is performance of the specific function to be assured?

It must be remembered that an internally designated fund is capable at any time of being diverted by the trustees to some other purpose, making the principal different in that respect from the truly restricted fund, and this potential must be disclosed. In bringing to light the existence of designated funds, the 1968 revision of *CUBA* recognized that designation does take place and must be disclosed, but left unsaid the basic premise that subsequent accounting and financial treatment would remain similar to that of restricted funds. Understanding and practice of this premise are essential to their proper function.

THE FUNDS STATEMENT — PRIME VEHICLE FOR DISCLOSURE

To assure better disclosure of financial management, the obvious recommendation is acceptance of the funds statement and the balance sheet as the *two* primary financial statements. In the 1968 revision, the funds statement was elevated to the status of a primary statement along with the balance sheet and the operating statement. For the future, it appears that disclosure of the financial position and of the financial changes of an institution will become clearer with two primary statements, rather than three. The funds statements would reflect total current expenditures and total additions to current funds in some detail, e.g., tuition received, unrestricted gifts, endowment income earned, and other unrestricted support formerly considered "revenue" as distinct from "funds." Maintaining that distinction hardly seems essential. ~~This expansion~~ would cause the operating statement to become a mandatory but subsidiary statement to the funds statement, giving a more detailed breakdown of the total expenditure figure and a more detailed showing of which funds were applied to cover expenditures.

Funds Statement In Primary Status

A subsidiary operating statement concentrating on expenditures is consistent with the concept that expenditures are the basic objective for these nonprofit institutions, and that the matching or application of "income" follows. The matching direction is the reverse of industrial accounting. Strong medicine such as this is necessary and desirable in order to de-emphasize the syndrome described previously — the preoccupation with net earnings or, call it if you will, the net results from operations. An analysis of the net increases of funds in each fund group and in total for the institution will be more meaningful. This is the overall view of the institution which trustees and the general public should be encouraged to take.

Further, in considering the primary statements, the columnar, totaled balance sheet and funds statement should be encouraged. These statements, with a column for each fund group or major subgroup and a total column, offer an effective means of presenting a fair and understandable picture of the resources of the university and the changes during the year. This bringing together in one statement of data for all fund groups reflects the integrated financial management for the institution as a whole.

This is not the place to deal specifically with design of a subsidiary operating statement as it relates to the funds statement. However, it must be determined whether a zero balance is mandatory or optional, and under what conditions. If optional, some requirements as to uniformity of treatment from year to year also would be needed.

Another general area of controversy and concern is the matter of interfund and intrafund transfers, allocations and the like. The 1968 revision undertook to set forth guidelines and some limitations on the presentation of various types of transfers in the statements. Those provisions in the 1968 *CUBA* need careful study, taking into account the problems which are now becoming visible such as expenditure of capital gains on invested funds and use of stabilization reserves for averaging endowment incomes over several years. Unquestionably further changes will be needed in this area. There is a strong inter-relationship between guidelines for transfers and allocations on the one hand, and the concept for the operating and funds statements. It may be expected that if the funds statement becomes dominant as here recommended, all transfers will be reported on it, where both sides of the transaction are visible and the effect on each fund group can be determined.

In the design and preparation of the statement of changes in fund balances, we must find ways to discourage and avoid the netting or offsetting of transfers between funds. The statement of changes in fund balances which grosses the transfers between funds may be less streamlined, but it will be responsive to proper standards of adequate disclosure to the public.

In conclusion, the choice then as to direction for better financial disclosure by colleges and universities is between expansion of the current funds statement of revenues and expenditures and a more complete funds statement. It is the writer's belief that the funds statement is the better vehicle. It offers the potential for better reflection of the financial management as it actually took place, for better understanding of the educational operation on the part of trustees and the general public, and for complete financial disclosure — the whole institution and all its resources.

Let us also take a broader view of financial management for higher education as we proceed to revise *College and University Business Administration*. Let us remind ourselves that, as becomes an important institution of American society, universities are ongoing and progressing. There is every intention on the part of governing boards and staff to fulfill responsibilities and commitments for instruction, research and public service for years to come. It is essential that financial management for higher education, on an annual basis consider and weigh future needs alongside those of the day. Not all institutions will manage in the same manner nor with the same emphasis, but that is the prerogative of each. The recommendations to encourage reporting according to published standards must allow sufficient flexibility to accommodate diversity, and be free of bias or pressure toward emphasis on either today or tomorrow. At the same time they must insure that financial management and resources are fully disclosed. Let us face up to the conflicting pressures from our educational constituents on all sides, re-examine our accounting concepts of theory, principles, and standards, and deliberately seek new insights and ways to operate.