GASB Staff and NACUBO APC Virtual Meeting
November 10, 2021, 3:00 (EST)

AGENDA

1. Introductions
   GASB attendees: Joel Black, Brian Caputo (board members), Deborah Beams (new liaison to higher education constituents), Lisa Parker (FRM and note disclosures), Robert Reese (conceptual framework and FRM), Scott Reeser (FRM and capital assets), Jialan Su (investment and fair value), Alan Skelton, Director of Research and Technical Activities

   NACUBO attendees: Sue Menditto, Bob Kuehler, Shea Bryant, Teresa Edwards, Tom Ewing, Mary Fischer, Chad Greenwell, Sharon Heinle, Anita Kovacs, Shannon Turner, Mary Wheeler

2. Definition of Operations (Sue, Theresa, Shea)
   a. Principles or rules-based interpretation (Statement 34, ¶102, footnote 42)
   b. Interpretive judgement: Lease revenue
   c. Financial reporting project: proposed subsidy presentation and definition of operations

   See notes on issues paper.

3. Fiduciary Activities (Bob, Tom, Anita, Sue)
   a. Control, administrative responsibility, and federal direct lending
   b. Separate fund reporting for BTAs

   See notes on issues paper.

4. Investments (Chad, Mary, Sue)
   a. Limited partnership investments and majority equity interests
   b. Funds functioning as endowments

   See notes on issues paper.

5. Ongoing communication between NACUBO and GASB
   a. Next steps concerning topics discussed at this meeting
   b. General communication preferences of the GASB
   c. Who will be the GASB staff liaison to NACUBO? Deborah Beams
   d. Possible webcasts with NACUBO

   GASB staff would be happy to participate in APC meetings and NACUBO sessions. Ongoing communications and open discourse are encouraged.

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APC Preparation

Background Information for agenda items

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Issues Paper
Meeting Discussion – Blue Font

Definition of Operations-Current and proposed definitions

Issue:

- SGAS 34 ¶102 and the accompanying footnote #42 states that a government's operating revenues and expenses are dependent on the government's policies and the nature of the activity being reported; and can be informed by how transactions are categorized on the statement of cash flows. For transactions that would not typically be classified as operating on the statement of cash flows, the footnote to the paragraph introduces flexibility for reporting transactions as operating <u>when those transactions constitute the proprietary fund's principal ongoing operations.</u>
- How broadly can ¶102 and the footnote #42 be interpreted? The financing example is very specific to categorization on the statement of cash flows. However, what about activities that constitute a public institution's ongoing principal operations and are not considered financing, investing or capital activities? Public institutions can have many activities considered operating: from providing loans and financial aid grants to students, to events' management and ticket sales, media communications, housing, dining, parking, research, educational activities, and so forth.
- How broadly should the answer to Q 4.13 in Implementation Guide 2021-01 be interpreted? The answer explains why lessor interest income can never be operating, even if financing activities constitute the principal ongoing operation of a BTA or enterprise fund. **However, does the answer extend to the rental portion of income and establish guidance for how all lessor activity should be viewed – thereby making ¶102 and the accompanying footnote #42 in Statement 34 not applicable to BTA lessor activity?**
    - In other words, when BTA lessors convey to a lessee the right to use an underlying asset, is the "right to use" the activity that is evaluated as operating or non-operating rather than the purpose for which the asset is used?
    - See questions 1 and 2 below, where the purpose of the lease activity resembles operating activities of a university (however, conveying control of the right to use an underlying asset would not resemble an operating purpose).

Reporting lease revenue:

This definition and flexibility have led to questions for reporting the components of lease income on the statement of cash flows and the statement of activities.

1. Can lessors report lease revenue that is integral to their operations (such as leasing a residential building to a third-party to house students) as operating revenue?
2. Can lessors report lease revenue that is similar in kind to other types of operating revenue as operating revenue? (for example, leasing space to educate non-enrolled citizens/students or leasing space for high-school athletic events)
3. Is there interpretive flexibility in Statement 34, c and the accompanying footnote 42? The genesis for question 1 and 2 is that some state auditors believe all lessor revenue would be non-operating. Although public institutions are not leasing companies, because revenue resulting from parking, dining, events, housing, research, and educational activities are all examples of revenue considered operating, then by analogy, wouldn't lessor revenue related to these services also be considered operating?

Summary of lease revenue discussion:

R Reese: Question 4.13 in the newly issued implementation guide only address the financing component of lessor revenue and does not affect how lessors report the rental component of lease revenue.

GASB representatives tended to agree with NACUBO's interpretation concerning typical college and university operating activities. Consequently, for example, rental income can be considered operating when athletic fields are leased to high schools for sporting events, when facilities are leased to third parties to house students, or when space is leased to community groups for educational activities. However, interest income for such lessor activities would never be considered operating.

Financial Reporting Model:

NACUBO has followed the Financial Reporting Model project and the proposed definitions for the terms "subsidies" and "operations". We are especially concerned with the proposed definition of operations, because it's defined in terms of what it isn't (everything that isn't nonoperating), rather than what it is.

The exposure draft listed four categories of nonoperating revenues and expenses:

- subsidies received and provided
- revenues and expenses related to financing,
- resources from the disposal of capital assets and inventory
- investment income and expenses.

Subsidies are defined as "(a) resources received from another party or fund to keep rates lower than otherwise would be necessary to support the level of goods and services to be provided or (b) resources provided to another party or fund that results in higher rates than otherwise would be established for the level of goods and services to be provided."

Two questions arise based on these definitions.

1. Pell grants do not meet the proposed definition of a subsidy, nor do they fit into the other non-operating categories – therefore are we correct to conclude that Pell grants will be considered operating revenue under the proposed standard?
   a. GASB staff came to this conclusion during the field tests, has this conclusion changed?
   b. What about consistency across higher education institutions? For example, Colorado treats support for public institutions similarly to the federal Pell grant, meaning, appropriations are provided to students and would not be a subsidy. Most public institutions do not receive appropriations this way, so most would have appropriations as subsidies.
2. The definition of a subsidy does not include a concept of availability in the period the funds are received. Will gifts to establish endowments, or other restricted gifts, be reported as a subsidy, when only the income from the endowment is available for spending in a subsequent period (or the time / purpose restriction makes a gift available for use in a subsequent period)?

Summary of FRM discussion:
Roberta Reese stated that ¶102 of SGAS 34 will go away with the issuance of the standard to improve the financial reporting model. (FRM. The final standard is expected to be issued in the second quarter of 2023.

Joel Black explained The GASB is still deliberating the "subsidy" concept from the FRM exposure draft. NACUBO should feel confident that the staff will summarize the comments from the many letters they received, and that our comment on endowment gifts will be considered in the deliberations.

Fiduciary Activities
Issue: The implementation of SGAS 84 has raised the following issues for public institutions reporting as BTAs.

Federal direct lending (student loans)
SGAS 84 relies on the definition of administrative involvement contained in SGAS 24 ¶5 to assess other fiduciary activities. Consequently, paragraphs 11 and 12 criteria for assessing other fiduciary activities has led some public higher education systems (preparers) and state auditors to conclude that ***since direct lending is not a fiduciary activity*** – because public institutions have administrative involvement – ***then direct lending should be recognized as revenue when received and an expense when loan funds are provided to students.***

a. Direct lending activities have been reported on the Statement of Cash Flows since public institutions implemented Statements 34 / 35.
b. For over two decades, public higher education has been told by GASB staff that Statement 24 applies to grants and not to loans, such as federal direct student loans. (because the loans must be paid back, they are not considered grants and were not considered in the scope of Statement 24)
c. Twenty years ago, NACUBO published a GASB 35 Implementation Guide with the help of PwC and GASB staff. The publication was distributed to thousands. Question 83 indicates that direct loans are not revenue and expense transactions.
d. During a meeting on May 24, 2021, GASB staff informed NACUBO that a Statement 24 file memorandum exempted federal direct loans from the requirements of Statement 24. That same week, GASB staff also informed Florida public institutions that direct lending is not revenue.
e. **Since direct lending is not revenue (or expense) – and administrative involvement per Statement 24 is not directly applicable – the activity is neither fiduciary nor recognizable on the SRECNP.**

Fiduciary fund reporting by BTAs

- Statement 35 amended Statement 34 and allowed public institutions to report as special purpose governments engaged only in business-type activities (BTAs). Public institutions reporting as BTAs **do not have to provide** dual perspective statements—funds and entity-wide. [Note: public institutions must now report single employer defined benefit pension plans in a fund statement, however, the presentation does not result in a change to assets and liabilities reported in the single column BTA.]

- As a result of implementing Statement 84, the reporting entity has been separated into two parts (fiduciary fund(s) plus single column BTA = entity-wide public institution). This presentation has created challenges when reporting cash, investments, and other consolidated assets for which a portion is held on behalf of other parties.
    - **Breaking apart the reporting entity is having unintended consequences and is not a faithful representation of the public institution reporting entity.**
    - Pulling a fund (activity) apart from the enterprise creates “quasi” enterprise-wide reporting and “quasi” fund reporting.
    - Possible solution to explore: Leave the public institution’s enterprise-wide single column BTA intact and report “the fiduciary fund statement” as RSI or a note disclosure.
    - NACUBO would like to better understand GASB’s objective regarding the fiduciary fund reporting requirement for public institutions. Fund reporting supports accountability, especially given legal budget obligations of state and local governments. Higher education does not have such obligations, as such this was a major basis for conclusions in Statement 35.
        - We do not believe our users find greater value in understanding fiduciary activities because there is a fund statement rather than a meaningful disclosure that explains fiduciary assets and liabilities in the single column BTA reporting presentation.
        - Users of public institutions’ financial statements (for example bond rating or accrediting agencies) are already separately analyzing material assets and liabilities held or invested for others.

<u>Reporting fiduciary funds as net position</u>

- Fiduciary funds are reported as net position (fund reporting). However, at an entity-wide level, the funds held for others would be liabilities because they are held for other parties.
- When BTAs utilize the 90-day exception, and report funds held for others on the proprietary fund Statement of Financial Position, the funds are reported as assets and corresponding liabilities. However, if those same funds do not meet the 90-day exception and are reported in the Fiduciary Funds statements, they would be reported as assets and net position.
- Because BTAs do not use dual perspective reporting, this creates an inconsistency (in addition to reporting concerns outlined above)

<u>Based on these issues, NACUBO requests that the GASB consider the following actions:</u>

1. Issue a technical correction, implementation guide question, or other guidance to confirm that direct lending programs are not grants and are outside the scope of SGAS 24.

2. Conduct a post-implementation review of SGAS 84 – for BTAs that do not use fund reporting – to determine if the goals associated with its issuance were achieved.

<u>Summary of Fiduciary Activities discussion:</u>

Lisa Parker has received 3-4 technical inquires on whether direct lending should be reported in the fiduciary funds statements. Her response is no, and is based on the following logic. Universities that participate in the direct lending program have administrative involvement. Therefore, direct lending is not a fiduciary activity, and Statement 24 applies. Statement 24 addresses pass through grants and other financial assistance; a discussion memo from 1992 (referenced in paragraph 19 of statement 24) excluded loans from financial assistance, and therefore, the direct lending program is outside the scope of SGAS 24. In other words, there is no authoritative guidance on financial reporting of federal direct loans, and industry guidance can be followed. Lisa expects that the revenue and expense recognition project will address these programs.

GASB could issue an implementation guide question, but they are limited to addressing what the program is, rather than what it's not. NACUBO could consider issuing a tutorial or adding information to the FARM that modernizes question 83 in the SGAS 35 /35 implementation guide.

Anita Kovacs explained the situation in Florida where one of the states 27 institutions manages the self-insurance pool, and asked how the institution would report the pool on its statements and when consolidated into Florida's state government statements. Lisa Parker responded with an answer involving the difference between fiduciary activities within component units of a reporting entity and fiduciary fund component units – all agreed the situation was confusing and the response difficult to follow.

The concern within the State is that this will not include the liabilities and assets in either the self-insured medical and property insurances which are very material to what is reported for the College System within the State ACFR. These have been included as part of the fund 6 – Agency amounts in the past and going forward these will be missing/excluded. Florida has extreme weather and millions flow thru the property programs (not to mention just the regular medical programs). The Florida consortium of institutions provides coverage on all hurricane claims so that the College deductible is $10,000 and all amounts due from FEMA are carried by the Consortium until the time FEMA pays. This allows individual institutions to manage regular hurricane losses without affecting operations. But if the Consortium is excluded because of fiduciary activity rules, then significant liabilities will be excluded in addition to assets held to settle the liabilities. For example, the amount of money that the Consortium is going to float for Pensacola State College on Hurricane Sally is about $5.8 million on a $23 million loss. Since it takes FEMA about 5-10 years to repay, the amounts add up and there is a loss of magnitude to some degree every year.

Most in Florida feel that separating the Consortium in the College statements is ok since they are segregated from College operations but to exclude the Consortium from the rollup in the ACFR is misleading since the exclusion of self-insured assets and liabilities seems like not sharing significant summary information. Requirements for self-insurance require minimum reserves. Every year, the one College that does not participate in the Consortium has to defend to the Legislature the "excessive" amount of reserves that they need to keep in order for their plan to pass regulatory scrutiny. When you add up the required reserves on several billion dollars of assets for property coverage in Florida for 27 Colleges, you are excluding a significant sum.

Lisa Parker commented on the issue regarding fiduciary funds reporting by BTAs that has changed the emphasis on one reporting entity. SGAS 34/35 established both the BTA standalone reporting and required government entities with fiduciary activities to report their fiduciary funds. Apparently, there is a paragraph in Statement 34 that requires enterprise and proprietary funds to report fiduciary fund statements. What was missing in SGAS 34/35 was combining the BTA and fiduciary activities requirements.

Alan Skelton and Lisa Parker said that the GASB is planning to do a post-implementation review of SGAS 84.

Investments *and* Reporting Majority Equity Interests in a Legally Separate Organization (Stmt 90)
Issue:

- Alternative investments (typically limited partnership structures) are common investments held by an institution's endowment investment pool. The endowment investment pool can consist of true donor restricted endowments and funds functioning as endowments (FFE).
- An interpretation of SGAS 90 that limited partnership interests (in excess of twenty percent) must use the equity method rather than fair value - because funds functioning as endowment do not quality as investments that can use fair value measurement – has created a measurement and reporting issue. [There may also be inconsistencies between public institution because the interpretation was provided to one audit firm and one institution (that NACUBO is aware of).]
- True endowments and FFE do not have distinct holdings in the endowment investment pool. It's costly, burdensome, and a misrepresentation of investments held by the pool to break apart limited partnership interests into fair value and equity valuations.
- Are limited partnership investment interests subject to control criteria rules; do the rules only apply to general partners because of their ability to exercise control?

Example, paragraphs in Statement 90, and interpretation provided by GASB staff:

1. The institution's consolidated investment pool holds a majority percentage as a limited partner in numerous alternative investments.
2. Funds functioning as endowments (FFE) participate in the consolidated investment pool and therefore, share in the investments.
3. Guidance in paragraphs 5 and 6 of SGAS 90:
   - Paragraph 5: A government can own or acquire a majority equity interest in a legally separate organization (for example, through acquisition of voting stock of a corporation or acquisition of interest in a partnership). If a government's holding of that equity interest meets the definition of an investment in paragraph 64 of Statement 72, the equity interest should be reported as an investment and measured using the equity method in accordance with paragraphs 205-209 of Statement 62, as amended, except as provided in paragraph 6 of this Statement. **[emphasis added]**
   - Paragraph 6: If a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund hold a majority equity interest in a legally separate organization that meets the definition of an investment, that majority equity interest should be measured in accordance with the requirements of paragraph 64 of Statement 72. **[emphasis added]**
4. **Because paragraph 6 does not explicitly mention funds functioning as endowment, GASB staff have informed PwC and at least one institution that this paragraph does not apply.**

<u>NACUBO's Interpretation:</u>

- Paragraph 6 of SGAS 90 does not explicitly exclude FFE, nor does the remainder of the standard.
- Statement 72 similarly does not distinguish between FFE and other endowment funds. Paragraph 64 of Statement 72 would include FFE investments participating in the consolidated investment pool. **FFE investments align with the overarching principal in Statement 72: investments are held primarily to generate income, have a present service capacity based solely on the ability to generate cash, and are measured at fair value.**
- Paragraph 5 of Statement 90 references paragraphs 205-209 of Statement 62, as amended, for **partnership interests.** Paragraphs 205-209 focus on a government's ability to exercise significant influence over operating and financial policies of an investee.
    - Because exercising influence can be subjective, those paragraphs define influence as ownership percentages over 20 percent; when the 20 percent threshold is crossed, the equity method of accounting and reporting is required.
        - In a **limited partnership structure,** general partners have control and influence, **limited partners capitalize the "organization" or "venture" as investors and do not exert influence.** There are legal, scholarly, and business articles that support this assertion.
        - **Paragraph 5 references <u>partnership</u> interests and <u>not limited partnership interests</u>.**
- Consequently, NACUBO believes that paragraphs 205-209 of Statement 62 would not apply when the investment structure is a limited partnership.
    - Fair value measurement per Statement 72 would apply.
    - Additionally, because Statement 90 does not explicitly exclude FFE, paragraph 6 applies, and fair value measurement and reporting would be appropriate.

<u>Based on the above points, NACUBO requests:</u>

- NACUBO would like the GASB to reevaluate and consider board designated FFE as similar to true and term endowments when applying standards related to investments (e.g. Statement 90).
- However, because of concepts, definitions, and conclusions about investments in Statement 72, NACUBO questions whether land held as an investment by an FFE should be excluded from fair value measurement (as required in Statement 52).
- NACUBO also seeks clarification concerning whether partnership interests (and the notion of control) are inclusive of limited partnership investment structures. Statement 72 addressed alternative investments and valuation considerations when there is no public market pricing. Alternative investments would typically include **limited** partnership structures.

<u>Additional information -- FFE:</u>

- FFE are important to the mission and access roles of public institutions
    - Dwindling state support of public higher education over two plus decades
    - 75 – 80% of students attend public higher education
    - Increasing numbers of graduates contribute or bequest funds that become FFE

  - FFE supports access through student scholarships
  - FFE support new program development
- Public higher education is likely GASB's only constituent group with FFE

Summary of Investments discussion:
Scott Reeser explained that a majority equity interest - regardless of whether the holding is as a general partner or a limited partner - means the government has accountability, unless the interest meets the definition of an investment. He also explained that the guidance in SGAS 52 – that funds functioning as endowments are not endowments – established the definition of endowments in subsequent statements.

The question remains, how to reconcile ¶77 of SGAS 72 (appended below) with SGAS 90.

Equity Interests in Common Stock
77. Equity interests in common stock, as described in paragraphs 202−210 of Statement 62, should be accounted for using the equity method if they meet the criteria in paragraphs 205−208 of Statement 62 and are not specifically excluded below. The following investments are excluded from using the equity method of accounting:

a. Common stock held by:
   1) External investment pools
   2) Pension or other postemployment benefit plans
   3) Internal Revenue Code Section 457 deferred compensation plans
   4) Endowments (including permanent and term endowments) or permanent funds
b. Investments in certain entities that calculate the NAV per share (or its equivalent) as provided in paragraphs 71−74 of this Statement
c. Equity interest ownership in joint ventures or component units as provided in Statement 14, as amended. [emphasis added]

NACUBO explained that

- Limited partnership alternative investments appear to be covered under GASB's definition of investments that use NAV (or its equivalent). Paragraph 71 describes ownership interests in partners' capital … which appears to describes the investor holdings in a limited partnership alternative investment structure. **Consequently, the FFE construct should not drive the decision to use NAV or equity method, but rather the investment type itself.**
- There has been no mention in GASB's literature subsequent to the issuance of Statement 52, or in the basis for conclusions in Statement 52, that the exclusion of FFE from holding land as an investment sets a precedent for FFE not being considered an endowment in subsequent literature. In Statement 52, FFE were excluded because the board did not want managements' designations to influence valuation for land.