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February 13, 2019

David Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

RE: Project No. 3-25

Dear David:

On behalf of the National Association of College and University Business Officers (NACUBO), we submit the following comments on the Preliminary Views (PV) of the Governmental Accounting Standards Board, *Financial Reporting Model Improvements*. NACUBO's comments on the PV were developed with input from our member institutions and our Accounting Principles Council (APC). The APC consists of experienced business officers from various types of institutions who, collectively, possess a thorough knowledge of higher education accounting and reporting issues and practices.

NACUBO is a nonprofit professional organization representing chief financial and administrative officers at approximately 2,000 colleges and universities. In its capacity as a professional association, NACUBO issues accounting and reporting industry guidance for higher education and educates more than 2,000 higher education professionals annually on accounting and reporting issues and practices.

Overall Observations and Conclusions

We appreciate the time and effort that the staff have devoted to this project and support the use of a PV document for this type of project. NACUBO thanks the GASB and its staff for the proposed Statement of Revenues, Expenses and Changes in Net Position. Displaying a performance metric that includes operating revenues, expenses, and noncapital subsidies will help readers of public institutions' financial statements understand their financial results.

We understand the PV is focused on improving the components and display of financial reports and is not addressing the definitions and recognition criteria for revenues and expenses or non-exchange transactions (for example, not revisiting Statements 24 and 33). However, public institutions participating in the field test have noted inconsistencies with on behalf payments that are currently reported as nonoperating revenue and do not meet the proposed definition of

a subsidy. Consequently, revising the display of financial reports while retaining the current definitions may exacerbate the inconsistencies that exist in the current reporting model, as noted in the comments below.

Chapter 4: Proprietary Fund Financial Statements

Definition of Operating Revenues and Expenses and Description of Nonoperating Revenues and Expenses

The Board's preliminary view is that operating revenues and expenses should be defined as revenues and expenses other than nonoperating revenues and expenses. Nonoperating revenues and expenses include (a) subsidies received and provided, (b) revenues and expenses related to financing, (c) resources from the disposal of capital assets and inventory, and (d) investment income and expenses. (PV Chapter 4 para. 3)

NACUBO is concerned that defining the important concept of *operating* as “other than nonoperating revenues and expenses” belies the criticality of operating results for financial reporting. Perhaps the definition of *operating* could be both a “default” and conceptual—and retain the notion conveyed in paragraph 102 of Statement 34 that stresses the nature of a transaction in relation to the purpose of the proprietary fund. We propose the following definition:

Operating revenues and expenses are those directly related to the purpose and primary mission of the proprietary fund. Revenues and expenses for activities that do not meet the definitions of (a) subsidies received and provided, (b) revenues and expenses related to financing, (c) resources from the disposal of capital assets and inventory, (d) investment income and expenses, and (e) extraordinary items, are operating unless the inclusion as operating would misrepresent “operating income (loss) and noncapital subsidy” results reported on the Statement of Revenues Expenses and Changes in Net Position (SRECNP).

Critical to the above definition is the qualifier in footnote 42 of paragraph 102 of SGAS 34, which indicates that in some cases, classifying revenues or expenses as operating may be based on the proprietary fund’s primary activities. Footnote 42 to paragraph 102 of SGAS 34 reads:

“Revenue and expense transactions normally classified as other than operating cash flows from operations in most proprietary funds may be classified as operating revenues and expenses if those transactions constitute the reporting proprietary fund’s principal ongoing operations. For example, interest revenue and expense transactions should be reported as operating revenue and expense by a proprietary fund established to provide loans to first-time homeowners.”

Therefore, we suggest that the concepts in the footnote be retained to illustrate a conceptual definition of operating. However, if the proposed definition is adopted, NACUBO acknowledges that defining operating as “everything else” is a practical approach. For either

approach, it will be critical for the other elements to be defined very clearly, including examples illustrating each concept.

Subtotal for Operating Income (Loss) and Noncapital Subsidies

The Board's preliminary view is that, in addition to the subtotals currently required in a proprietary fund statement of revenues, expenses, and changes in fund net position, a subtotal for operating income (loss) and noncapital subsidies should be presented before reporting other nonoperating revenues and expenses. The Board's preliminary view is that subsidies should be defined as resources provided by another party or fund to keep rates lower than otherwise would be necessary to support the level of goods and services to be provided. (PV Chapter 4 para. 7)

NACUBO appreciates GASB's recognition that various forms of support contribute to a meaningful performance metric in the financial statements of public colleges and universities. However, we suggest that the definition of a subsidy be modified to address the following concerns.

Current period concept

The proposed definition is silent as to the period to which the provided resources must relate. Field tests conducted by higher education institutions led to confusion as to where to record gifts for endowments, which meet the proposed definition of a subsidy (i.e., resources provided by another party or fund to keep rates lower than otherwise would be necessary to support the level of goods and services to be provided.) Therefore, we suggest a concept of "resources available for use in the current period" to clarify the definition.

The notion of "resources available for use in the current period" makes clear that the gift of a permanent endowment is not a current reporting period subsidy but rather a "financing and investment activity." However, as explained below, the same concept would allow reporting period endowment fund spending distributions to be reflected as a noncapital subsidy because such resources keep rates lower than otherwise would be necessary to support the level of goods and services provided.

Endowment Funds

NACUBO requests that the GASB consider the authorized spending from endowment funds as a subsidy because annual amounts appropriated by the governing board and used in the current reporting period meet the proposed definition. Special purpose governments engaged in business-type activities that report as BTAs, such as hospitals and higher education institutions, have endowments for which a portion of the annual investment returns are used as resources to pay expenses and keep rates lower than would be necessary to support the service provided. Endowment fund resources are appropriated by the governing board annually based on an approved spending rate. Investment returns that exceed the spending rate are accumulated to protect for inflation and for use in periods when the return does not sufficiently cover the spending rate.

For example, a BTA holds an endowment with a market value of \$1,000,000 at the beginning of the current year. In the current year, the investment return is 7.5 percent, or \$75,000, and the spending rate is 4 percent, or \$40,000. The \$40,000 drawn from the endowment fund would be reported as a non-capital subsidy, and the remaining \$35,000 would be reported as investment income and expenses.

In the following year, the market value of the endowment is \$1,035,000 (\$1,000,000 plus the prior year's accumulated investment returns of \$35,000.) The spending rate is still 4 percent and the annual investment return is 2.5 percent. The university draws \$41,400 from the endowment fund to cover expenses (noncapital subsidy), and the amount shown as investment income and expense would be (\$15,525). (Total return of \$25,875 less spending of \$41,400 = negative \$15,525).

This treatment would also promote consistency between endowments held by separate foundations and endowments held by the reporting entity. The endowment spending distribution from a separate foundation that is transferred to the BTA (reporting entity) for spending would meet the proposed definition of a subsidy. It seems incongruous that the distribution for spending would be a subsidy if the endowments were held by another entity, and not a subsidy if the endowments were held by the reporting entity.

Third-party payments

We suggest that the definition of a subsidy be improved by specifically addressing named recipients or beneficiaries of other governmental or private resources as follows (additions are underlined):

Subsidies are resources provided by another party or fund to keep rates lower than otherwise would be necessary to support the level of goods and services to be provided. Payments by third parties to the primary recipients of the reporting entity's services are not subsidies.

This revised definition would make it clear that students' Pell Grants (or similar resources provided by state, local, or private entities) are not subsidies to the institution because the resources belong to designated students.¹ This would also provide clarity for other third-party payments to service recipients, such as Medicaid payments to hospitals and health care facilities.

We also suggest that the final standard include many scenarios to illustrate the subsidy concept.

¹ Statement 24, *Accounting and Reporting for Certain Grants and Other Financial Assistance*, is the reason that public institutions recognize Pell Grants as revenue even though the resources belong to qualifying students, as determined by the federal government. Students receiving Pell Grants can choose to attend any higher education institution and use Pell Grant resources to pay tuition and fees. (Economically, it is no different than patients qualifying for Medicare or Medicaid paying for medical services at any public or private health care facility.) Because Pell Grants are nonexchange transactions per Statement 33, *Accounting and Financial Reporting for Nonexchange Transactions*, public institutions currently reflect Pell revenue as nonoperating. Although Statement 33 will be reexamined as part of the "revenue and expense project," we ask the GASB to consider revisiting Statement 24, which was issued years before the current reporting model.

Presentation of Major Component Units

The Board's preliminary view is that if it is not feasible to present major component unit financial statements in a separate column(s) in the reporting entity's statement of net position and statement of activities, the financial statements of the major component units should be presented in the reporting entity's basic financial statements as combining financial statements after the fund financial statements. (PV Chapter 6 para. 2)

The proposal is not clear as to whether it is addressing blended component units (BCU), discrete component units (DCU), or both. When component units qualify for blending, it would be misleading and burdensome to tease them apart from the college or university reporting entity.

It is also unclear whether the proposal is only for primary governments that present fund financial statements. Since a few public institutions now present fiduciary fund financial statements, we ask for clarity.

If the proposal is addressing only DCU, please clarify which of the following statements accurately describes the proposal:

1. When optional combining statements of discrete component units are presented, they must be shown as financial statements rather than notes to the financial statements.
- OR
2. Combining statements of discrete component units are required financial statements.

If it's the first, NACUBO would prefer that the option to present as statements or notes be retained.

Presentation of Expenses by Natural Classification

The Board's preliminary view is that state and local governmental entities that prepare a comprehensive annual financial report should present a schedule of natural classification of government-wide expenses by function or program for governmental activities and by different identifiable activity for business-type activities. (PV Chapter 6 para. 5)

Please clarify if this proposal is eliminating the option for BTAs to show either natural or functional classification on the face of the statements, and instead will now require BTAs to report expenses in the functional classification on the SRECNP. If so, NACUBO disagrees with this proposal. Our member institutions have developed reporting practices that meet the needs of their readers. Requiring a one-size-fits-all approach for reporting expenses on the SRECNP disregards the variety of programs delivered by BTAs and would harm the usefulness of financial reporting.

Alternative View: Government-wide Statement of Cash Flows and Elimination of Proprietary Fund Statement of Cash Flows in Government-wide Financial Statements

The government-wide cash flows statement would be presented in a columnar format with separate columns for governmental and business-type activities together with a total column for the primary government. (Chapter 7 para. 20)

NACUBO agrees with the reasoning to show only a government-wide cash flow statement, because governments seldom manage cash at the individual fund level.

In closing, we wish to express our appreciation for the opportunity to comment. We welcome the opportunity to participate at any of your public hearings and look forward to answering any questions the Board or the staff may have about our response. Please direct your questions to me at 202-861-2542 or smenditto@nacubo.org.

Sincerely,

Susan M. Menditto
Senior Director, Accounting Policy