February 26, 2021

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. 4-6P

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, Revenue and Expense Recognition. NACUBO is a nonprofit professional organization representing chief financial and administrative officers at 1,700 colleges and universities. In its capacity as a professional association, NACUBO issues accounting and reporting industry guidance for higher education and educates thousands of higher education professionals annually on accounting and reporting issues and practices.

NACUBO’s comments on the PV were developed with input from its 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.

Observations

Introduction
We appreciate the time and effort that the staff has devoted to this project and support the use of a PV document and field testing for a project as significant as this.

NACUBO appreciates that the new recognition model includes the following aspects:
- Guidance for recognizing revenues and expenses arising from exchange transactions
- Symmetry of revenue and expense recognition methods
- Standards that address most government revenues

Exchange/Non-Exchange Considerations
We submit that the benefits cited above, as well as improved guidance and more consistent financial reporting, could be achieved by retaining the exchange / nonexchange model. As stated
in our letter responding to the Invitation to Comment, we continue to believe that the exchange/nonexchange model can be the foundation upon which revenue and expense recognition conceptually rests.

Existing nonexchange guidance provides a suitable basis for analyzing transactions. Remedies for inconsistencies can be provided through improved writing and examples. For example, concerning inconsistencies in the reporting of non-exchange transactions, enhanced guidance could help clarify differences between eligibility and restrictions. Current non-exchange guidance was used to analyze accounting and financial reporting for various 2020 Coronavirus Aid, Relief, and Economic Security Act programs, and was substantiated. If anything, analyzing the CARES Act exposed areas of misunderstanding in the densely written Statement No. 33, rather than exposing weaknesses in the foundational principles underlying nonexchange guidance. Further, conclusions reached using Statement 33 aligned with FASB’s recent nonexchange guidance and its application to CARES Act programs. (FASB’s nonexchange guidance updates were needed to accommodate changes brought about by its revised performance-based exchange transaction revenue recognition model.)

The reality is that sufficient authoritative transaction guidance is lacking for exchange transactions. Whether in the private or governmental sectors, exchange transactions are more likely to contain performance obligations. There is an opportunity for improved and new guidance to focus on refining the concept of exchanged value and its relationship to receipt and provision of service performance attributes in binding arrangements. Why not focus on performance-based exchange guidance and improve an existing and workable model for nonexchange transactions?

**Complexity and Gaps in the PV Document**

Should the Board decide to continue with a new recognition model, NACUBO has identified significant gaps in the proposed model, described herein. Due to the significant unresolved items, we ask the Board to consider issuing a second PV addressing open issues, prior to issuing an exposure draft. Otherwise, constituents will not have input into changes between the PV and exposure draft. It is our understanding that GASB does not significantly alter exposure drafts.

**Performance Obligations**

We ask for clarity concerning the relationship between unit of account and performance obligations. By referencing paragraph 8 of SGAS 72, the PV document associates the performance obligation with the unit of account to tie revenue/expense recognition with corresponding assets or liabilities. However, the association is confusing because it can be challenging and subjective to break down governmental services into performance-based units. This approach would make more sense if government performance obligations were predominantly sales of products, which is not the case.

In a governmental environment, whether providing water to citizens, educational services to students, or performing research for a grant sponsor, the notion of disaggregating performance obligations into units of account is incredibly complex and will require significant analysis for
recognizing revenue or expense. For example, the units of account associated with a university’s educational enterprise could be disaggregated into classroom instruction, tutoring, access to virtual platforms, library use, lab work, independent study, testing, student counseling, campus safety, career planning, etc. Educational activities are only one example illustrating the challenges of defining the unit of account for governmental services. Research supported by external sponsors is another, with numerous performance obligations required to achieve major milestones that align with expenditure reimbursement requests.

**Negotiated and contractual discounts**

**Price waivers:** NACUBO is concerned that the Board has deferred consideration of negotiated discounts until a later due process document. As such, various published discounted prices were not part of the field test. Public higher education often provides the exact same educational services at varying prices that are based on characterizations of student groups. For example, published tuition prices are reduced for public servants and senior citizens compared to prices for traditional instate and out-of-state undergraduates.

**Financial aid:** Higher education field testers were instructed to evaluate gross tuition revenue, gross student fees revenue, and “scholarship expense” as separate transactions. While it is possible to look at these transactions separately, it is not a faithful representation of the higher education business model. When an institution offers a financial aid package to a student—and we can only assume this is how GASB was defining scholarships—the contractual price in the binding arrangement with the student is inclusive of aid. Financial aid reduces the published price for tuition and fees to arrive at a student’s contract price.

We question whether a student’s financial aid package is a scholarship expense or a price reduction under the proposed framework. Currently, financial aid is considered a scholarship allowance that reduces the published price of tuition (commonly referred to as a tuition discount). How these agreements with students are categorized will have a significant impact on revenue recognition and measurement—and, ultimately, financial reporting for public colleges and universities.

**Application of the model to grants**

**Sponsored research:** A significant number of universities (both public and private) serve as the research arm of the federal government. Public universities performed two-thirds ($52.1 billion) of academic research and development in 2018, with approximately 50% funded by the federal government and the remainder funded from a combination of other academic institutions, state and local governments, businesses, nonprofit organizations, and other sources.¹ Research grants are complicated transactions, with provisions addressing deliverables, intellectual property, changes in dedicated personnel, performance milestones, administrative requirements, programmatic and administrative reporting, budget modification requirements, and payment terms, to name a few. Each of these elements may influence whether sponsored research is classified as a Category A or B transaction.

Determining interdependence for expenditure-driven and purpose-restricted grants:

Unfortunately, the recognition guidance in Chapter 3, paragraphs 28 to 30, Application of Interdependence to Expenditure-Driven Grants and Purpose-Restricted Grants, is grossly inadequate to address various types of donor and grantor support as well as the complexities of research grants. For example, the distinction between an obligation to honor very specific purpose restrictions (not interdependent) and an interdependent obligation to provide goods and services is not clear. The examples in the paragraphs provide limited detail related to the underlying agreements. In fact, concerning the expenditure-driven grant to provide services to the elderly, paragraph d (step 4) on page 28 indicates that “if resources were provided in advance, the recipient would not be entitled to those resources” (emphasis added).

If resources were provided in advance, there is no difference between the grant for elderly services and the grant for early childhood services. Without the expenditure-driven nature of the elderly services grant, there is merely a restriction to serve the elderly. More discussion is needed to clarify how “providing certain services to the elderly” rises to the level of interdependency, while funding an Early Childhood Services program does not. If it is merely the expenditure-driven nature of the agreement that creates an interdependency, more information is needed to clarify interdependent relationships. An example of additional interdependencies might be that funds provided in advance would need to be returned to the grantor if services are not provided to the elderly.

Pell Grants: Another example concerning the need to understand interdependent relationships is Pell Grants. One of the public institutions participating in GASB’s field test concluded that a Pell Grant would be considered a Category A Transaction. However, upon further examination, we are struggling to identify the significance or even existence of the interdependencies.

Pell Grants are a federal need-based student aid program under Title IV of the Higher Education Act. Congress sets the need-based eligibility rules and the U.S. Department of Education (ED) determines whether a student is eligible to receive a Pell Grant based on a student’s Free Application for Federal Student Aid (FAFSA). Students identified as Pell Grant-eligible by ED who enroll at a college or university are expected to use their Pell Grant as a source of payment for tuition and fees via direct payments from ED to the university. When Pell Grant amounts exceed tuition and fees, the institution disburses the difference to the student. Pell Grant amounts are adjusted if the student is enrolled less than full-time.

Field test four-step assessment for Pell Grants classifying them as Category A:

1. The program participation agreement between the university and ED is the binding arrangement for the transaction.
2. The university and ED approve the terms of the agreement once every four years. Both the university and ED have the capacity to bind their entity and itself, respectively. For those reasons, there is mutual assent by the parties.
3. Each party has significant rights and obligations. The university has the right to draw funds from ED and apply funds to outstanding charges on the student’s account. The university is obliged to ensure that the student attends the university for a pre-determined time period. ED has the obligation to process a transfer of funds to the university and the
right to request information about payment administration and student enrollment.
4. The rights and obligations are interdependent. The university’s right to consideration is dependent on the federal aid provided and administration of the federal aid to the student. ED’s right to enforce that Pell aid is provided to eligible students is dependent on its obligation to transfer funds to the university based on university requests for funds.

Field Test Analysis: The interdependencies in Step 4 do not appear to extend beyond the rights and obligations in Step 3. The significant rights and obligations, and interdependencies (application of funds made available by ED to the student’s account for amounts charged by the university for educational services and enrollment verification through the first several weeks of classes) appear administrative and not substantive. Further, the university’s performance obligation to acquire and apply funds and verify enrollment retention also appears to be administrative in nature. It’s not clear whether the Category A framework is intended to replace the guidance in Statement 24, Accounting and Financial Reporting for Certain Grants and Other Financial Assistance.

Alternative view—four-step assessment for Pell Grants: Alternatively, the four-step assessment for Pell Grants could be bifurcated as follows: (1) the agreement between the student and the federal government for the grant aid and (2) the agreement between the institution and ED to administer Title IV financial aid.

Between the student and the federal government—
1. The binding arrangement is created when the student receives notice that they have qualified for a Pell Grant. The arrangement is between the student and the federal government. Because the binding arrangement for the Pell award is not with the institution, the funding to the student is neither Category A nor B and is not recorded as revenue and expense (although remaining steps can be analyzed as follows).
2. The FAFSA submission and Title IV rules create mutual asset.
3. An eligible student has a right to the federal aid by enrolling in an accredited institution and ED is obliged to provide funds to the student.
4. An interdependency exists because a student must maintain attendance for a specified period in an academic term or they lose educational funds; either the student or university return funds to ED depending on the circumstance.

Between the institution and ED—
1. The university and ED have a binding arrangement to participate in Title IV programs.
2. Both the university and ED have the capacity to bind their entity and itself, respectively. For those reasons, there is mutual assent by the parties to administer the program.
3. Each party has rights and obligations. The university has the obligation to accept the student’s notice of award in payment and to request payment on behalf of the student. The university is obliged to ensure that the student attends the university for a predetermined time period. ED has the obligation to pay the university an administrative fee for its services (approximately $10.00 per Pell Grant recipient) and an obligation to remit the award to the university on the student’s behalf.
4. The rights and obligations are interdependent. The university’s right to consideration (the
administrative fee) is dependent on providing the agreed upon administration of funds. ED has an obligation to pay for the services received.

The contrasting applications of the four-step process is presented here to illustrate that the results may be very different depending on the point of view of the parties applying the criteria. The binding arrangement between the university and ED is predicated on the binding arrangement for education (tuition and fees) between the student and the university. The federal regulation, vantage point, significance, and type of consideration affected conclusions. If consistency is desired, more work is needed to expand upon these concepts. Our question concerning the applicability of Statement 24 to the grant framework remains.

We recommend the Board and staff spend more time learning about the varieties and nuances of research grants and federal aid to include in a second PV addressing these transactions.

**Economic substance of rights and responsibilities**

In line with our discussion on Pell Grants and administrative responsibilities, economic value can’t be ignored. The model relies on categorizing transactions as either A or B based on the presence or absence of specific characteristics. The fourth essential characteristic of a Category A transaction are “substantive interdependent rights and obligations.” Chapter 1, paragraph 9 indicates that value reflects subjective perceptions of the parties to a transaction; and “value is not a characteristic of the item in the transaction nor of the transaction itself; therefore, it is not feasible to clarify the meaning of “value,” nor it is possible to evaluate whether substantive interdependent rights and obligations are present without considering the associated economic benefits (i.e., “value”) received and disbursed.

The concept of economic value is used as the basis for the example in Chapter 3, paragraph 21 of the PV comparing the exchange of a $100,000 donation for a lapel pin. In addition to being an overly simplistic example, the economic value of the exchange is the key point. In addition to resolving the inconsistency of when economic value is a factor, i.e. defining “substantive interdependent rights and obligations,” we suggest that a subsequent PV include a more nuanced discussion with complex examples, such as a donation by a company in exchange for naming a building or a grant from a philanthropic organization to support basic research. It’s not clear from the current PV document how these transactions would be categorized. In our opinion, the presence of “substantive interdependent rights and obligations” is another way of identifying an “exchange” transaction.

**Presentation of transaction categories in financial statements**

The lack of clarity about how GASB’s revenue and expense project connects to other critical projects in process, such as financial reporting, is challenging. The significance of a transaction being categorized as A or B when it comes to financial reporting remains to be seen. Further, the Board’s conclusion that revenues and expenses are of equal importance with recognition related to their respective applicability to a reporting period ought to influence presentation in the SRECNP under proposed financial reporting model rules. Analyzing transactions is enhanced by a more holistic understanding of the intent behind measurement, recognition, and presentation. Seeing the final presentation in the financial statements helps to determine whether the classification makes
sense to the users of higher education’s financial statements.

**Scope limitations based on the form of consideration, e.g. capital assets**

Public colleges and universities reporting as business-type activities may receive or dispose of capital assets in conjunction with donations, research grants, investments, or many other transactions. The exclusion of capital assets from the scope of this project is a major gap in what is described as a principles-based model. The form of consideration (financial assets or non-financial assets) used in a transaction should not affect the scope of transactions that are covered by the model. We seek clarification of how transactions involving capital assets as a form of consideration would be covered under this model.

**Other Observations**

Should the GASB choose to move forward with an Exposure Draft without clarifying the open issues noted above, we strongly suggest subsequent documents address the open items as well as the following corrections and clarifications.

**Decision trees for recognizing revenues and expenses**

Paragraph 20 of the PV document lists the following steps to determine when revenue is recognized. (Corresponding steps for expenses are described in paragraph 26.)

20. The proposed revenue recognition methodology consists of four steps as listed below and as depicted in the subsequent flowchart.

   a. Step 1: Does the government have an increase in net assets?
   b. Step 2: Does the increase in net assets result in a related liability?
   c. Step 3: Does the increase in net assets result in an inflow of resources applicable to a future period?
   d. Step 4: Recognize revenue.

Paragraph 21 references footnote 4 in Concept Statement 4, defining *net assets* as assets netted with liabilities. However, based on the decision steps listed in paragraph 20, if Step 1 is “true” (i.e., the government has an increase in net assets), then Step 2—a corresponding increase in liabilities—must be false. Please clarify that the first question should reference *assets* and not *net assets*.

**Clarify binding arrangements, mutual assent, and legal enforceability**

In the field test, public universities with health systems noted issues when applying the criteria for binding arrangements and mutual assent to healthcare transactions, which underscores the need to broadly define what constitutes a binding arrangement and mutual assent. Future guidance needs to include industry-specific examples, such as a healthcare example of caring for an unconscious patient.

Also, more clarity is needed on the point at which a legally enforceable claim arises for tuition. Colleges and universities require students to sign a Financial Responsibility Statement upon registration, which would appear to create a legally enforceable claim.
**Requesting Alignment for BTAs**

It would be helpful for governmental entities predominantly funded by business-type activities (BTAs) to have authoritative guidance aligned with GAAP applicable to private enterprises. Similar to the board’s incorporation of a performance obligation approach into this PV, it would be helpful if recognition of tuition and fee revenue, related financial aid price reductions, scholarship expense, and sponsored research were consistent between public and not-for-profit colleges and universities.

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