

# Financial Reporting in Higher Education

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In the following report, Hanover Research presents an overview of financial reporting practices among private and public higher education institutions in the United States. The first section of the report addresses the generally accepted accounting principles (GAAP) for private and public institutions, common budget models, and internal reporting trends. The second section presents considerations for financial reporting, as well as common software applications used, and discusses fundraising reporting. Finally, the last section of the report describes financial key performance indicators commonly used in higher education.

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# EXECUTIVE SUMMARY AND KEY FINDINGS

## INTRODUCTION

In this report, Hanover Research presents an overview of financial reporting practices among private and public higher education institutions in the United States. The report addresses the generally accepted accounting principles (GAAP) for private and public institutions as determined by the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB) respectively, as well as internal financial reporting practices, fundraising reporting, and typical financial software applications used in higher education. The report comprises three sections:

- **Section I** describes the GAAP standards for private and public institutions, highlighting differences in methodologies and report display. This section also reviews common budget models used in higher education and trends in internal reporting practices.
- **Section II** presents considerations for financial reporting in private and public higher education, along with information on financial software applications and fundraising reporting.
- **Section III** provides an explanation of common key performance indicators (KPIs) used in higher education to measure financial wellbeing as well as for internal and external benchmarking efforts.

## KEY FINDINGS

- **Higher education institutions prepare annual financial reports according to GAAP standards for private and public institutions, but also produce unaudited interim financial statements, and routine and ad hoc financial reports for internal management.** About two thirds of private institutions produce internal interim reports, usually on a monthly basis. Management reporting is even more common, with 83 percent of private institutions preparing management reports on an ongoing basis according to a survey by the National Association of College and University Business Officers (NACUBO).
- **Differing financial reporting standards set by FASB and the GASB make comparing financial statements for private and public institutions difficult.** Both reporting methodologies and display standards can vary greatly between these two guides. For example, the FASB allows indirect reporting for cash flow via three financial categories, while the GASB requires direct reporting across four different categories.
- **Most private baccalaureate colleges use the incremental budget model, and zero-based budgeting is the second most popular method.** This trend is also consistent among most private and public higher education institutions in general. However, many business officers are skeptical of their current budget model's ability to

- address specific tasks or challenges like managing resources during difficult times, helping set institutional priorities, helping develop business plans for new programs, or helping develop business plans for online activities.
- **Oracle and Sungard are the dominant providers of financial reporting software among higher education institutions, accounting for 61 percent of the market share in 2011.** The most common applications for financial reporting are Sungard HE Banner Finance (28%), Oracle Peoplesoft Financials (22%), and Datatel Colleague Financials (13%). About 7 percent of institutions reported using “homegrown” financial reporting applications.
  - **Public and private institutions may use different key performance indicators (KPIs) to evaluate financial resources.**
    - For example, the Higher Learning Commission (HLC) recommends three financial ratios for private institutions to assess financial health: primary reserve ratio, equity ratio, and net income ratio. The HLC proposes a different set of ratios for public institutions: primary reserve ratio, viability ratio, net assets ratio, and net operating revenue ratio.
    - Other common KPIs for benchmarking include secondary reserve ratio, net tuition by student FTE, tuition discount rate, debt coverage ratio, and fundraising expense to contribution ratio.
  - **Institutions may produce annual summary reports of fundraising success, as well as more frequent internal reports monitoring prospecting efforts.** Reporting efforts and metrics may change throughout the course of a fundraising campaign, and should be adapted to monitor the advancement unit’s progress toward meeting its mission or campaign goals.

## SECTION I: FINANCIAL REPORTING

In the United States, there are many different methods for financial reporting used among both public and private higher education institutions. Although the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB) provide some guidelines for standardization in private and public institutions respectively, reporting still varies widely among higher education institutions. In fact, according to a co-sponsored survey by the Association of Governing Boards of Universities and Colleges (AGBUC) and the National Association of College and University Business Officers (NACUBO), less than 25 percent of CFOs reported using a standard cost methodology that would allow benchmarking comparisons with other institutions.<sup>1</sup> Given the variations in financial reporting across institutions, it is useful to examine a number of standard cost methodologies and accounting standards for private and public higher education institutions.

In this section, Hanover Research first presents an overview comparison of the FASB and GASB reporting requirements. Then, we review five common budget models used in universities, along with the advantages and disadvantages of each approach. Finally, the section concludes with a review of internal reporting trends in private and public universities and colleges.

### GAAP STANDARDS

There are two accounting standards for reporting in higher education: the FASB standards required for private institutions and the GASB standards used by public institutions. However, between 1973 and 1997, both public and private higher education institutions generally followed similar reporting guidelines under the American Institute of Certified Public Accountants' (AICPA) College and University Audit Guide, developed in 1973. This changed when a not-for-profit audit guide was developed in 1997 to address issues like depreciation, contributions, and investments. In 2002, public institutions were required to transition to GASB reporting standards following the issuance of GASB Statement 35, which made the 1973 AICPA audit guide "obsolete."<sup>2</sup>

NACUBO explains that the disparities in standards for accounting under the FASB and GASB rules are driven mainly by "mission differences." The financial reporting for FASB entities is intended to educate investors and creditors on the financial status of private universities, while the GASB documents are used to support transparency of public and taxpayer money provided by government funding. Therefore, each board has its own standards for

<sup>1</sup> Wellman, J. "What Boards are Doing—and Not Doing—in Reviewing Institutional Costs." The Cost Project, Association of Governing Boards of Universities and Colleges. p. 3.  
[http://agb.org/sites/agb.org/files/report\\_cost\\_project.pdf](http://agb.org/sites/agb.org/files/report_cost_project.pdf)

<sup>2</sup> Goldstein, L. and S. Menditto. "GASB and FASB." *Business Officer Magazine*, January 2005. National Association of College and University Business Officers.  
[http://www.nacubo.org/Business\\_Officer\\_Magazine/Magazine\\_Archives/January\\_2005/GASB\\_and\\_FASB.html](http://www.nacubo.org/Business_Officer_Magazine/Magazine_Archives/January_2005/GASB_and_FASB.html)

accounting and reporting formats.<sup>3</sup> However, this can make it hard to compare spending in public and private institutions. For example, differences between cash flow reporting for these two accounting standards can make it “difficult to impossible for someone other than a professional accountant to compare the financial statements of, for example, a public and a private university.”<sup>4</sup>

### *FASB AND GASB ACCOUNTING DIFFERENCES*

NACUBO highlights 14 differences between FASB and GASB. These differences and their impacts on financial reporting are summarized in Figure 1.1 below. Differences in accounting can significantly affect financial data reporting. For example, investment income is distinguished as operating or non-operating in the FASB rules, but not in the GASB rules, unless from student loan programs.

**Figure 1.1: Differences in FASB and GASB Accounting Standards**

DESCRIPTION	FASB	GASB	IMPACT
Contributed Services	Allows recognition	No recognition	<ul style="list-style-type: none"> <li>• Gift revenue</li> <li>• Expenses</li> </ul>
Restricted Cash Contributions	Recognize as temporarily or permanently restricted	Recognized as deferred revenue, if use restricted to a future period	<ul style="list-style-type: none"> <li>• Liabilities</li> <li>• Gift revenues</li> <li>• Net assets</li> </ul>
Endowment Pledges	Recognize as permanently restricted	Recognition prohibited	<ul style="list-style-type: none"> <li>• Assets</li> <li>• Gift revenues</li> <li>• Net assets</li> </ul>
Restricted Non-endowment Pledges	Recognize as temporarily restricted revenue	Prohibits recognition if for future period use	<ul style="list-style-type: none"> <li>• Assets</li> <li>• Gift revenues</li> <li>• Net assets</li> </ul>
Investment Income	<ul style="list-style-type: none"> <li>• Recognize and display net against income</li> <li>• Recognize as operating or non-operating</li> </ul>	<ul style="list-style-type: none"> <li>• Display income net of related expenses</li> <li>• Cannot be operating revenue unless from student loan programs</li> </ul>	<ul style="list-style-type: none"> <li>• Line item display</li> <li>• Operating and non-operating categories</li> </ul>
Pell Grants	Balance sheet transaction	Activities statement transaction	<ul style="list-style-type: none"> <li>• Grants and contract revenue</li> <li>• Net tuition</li> <li>• Net assets</li> <li>• Liabilities</li> </ul>
Perkins Loans	Balance sheet transaction	Balance sheet or activities statement	Activities statement: <ul style="list-style-type: none"> <li>• Grants and contract revenue</li> <li>• Net assets</li> <li>• Liabilities</li> </ul>

<sup>3</sup> Goldstein and Menditto, Op. cit.

<sup>4</sup> Lohrey, J. “The Difference Between FASB and GASB Effects on the Statement of Cash Flow.” Chron. <http://smallbusiness.chron.com/difference-between-fasb-gasb-effects-statement-cash-flows-76401.html>

DESCRIPTION	FASB	GASB	IMPACT
Funds Held in Trust by Others	Included as assets	No recognition	<ul style="list-style-type: none"> <li>• Assets</li> <li>• Revenues</li> <li>• Net assets</li> </ul>
Restrictions Definition	Only donors can restrict	Any external party can restrict	<ul style="list-style-type: none"> <li>• Categorization of net assets</li> </ul>
Use of Restricted Funds	First dollar release mandated	First dollar release optional	<ul style="list-style-type: none"> <li>• Categorization of net assets</li> </ul>
Pensions and Other Post-Retirement Benefits	Expense and liability calculated consistently using FASB methodology	Expense and liability calculated consistently using GASB methodology	<ul style="list-style-type: none"> <li>• Measurement difference</li> <li>• Expenses</li> <li>• Liabilities</li> <li>• Net assets</li> </ul>
Software	Capitalization required	No capitalization required	<ul style="list-style-type: none"> <li>• Assets</li> <li>• Expenses</li> <li>• Net assets</li> </ul>
Impairment	Requires cash flow approach	Requires service utility approach	<ul style="list-style-type: none"> <li>• Assets</li> <li>• Expenses and losses</li> <li>• Net assets</li> </ul>
MD&A	No requirement	Explanatory information must be included with financial statements	<ul style="list-style-type: none"> <li>• MD&amp;A section</li> </ul>

Source: NACUBO<sup>5</sup>

### DISPLAY DIFFERENCES

Figure 1.2 on the following page describes differences in how financial statements present data according to FASB and GASB standards. Differences in the classification of financial information can make comparisons between public and private institutions difficult. For example, balance sheets have some fundamentally different net asset classes. The GASB includes unrestricted, temporarily restricted, and permanently restricted net assets, while FASB reporting uses capital, restricted and unrestricted net assets.<sup>6</sup>

Similarly, FASB and GASB have differing methodologies for cash flow reporting, with the FASB allowing indirect reporting via three financial categories while the GASB requires direct reporting across four categories.<sup>7</sup> The direct method, also known as the “income statement method,” calculates net cash flow by deducting cash disbursements from receipts originating from operational activities. The indirect method of reporting is known as the “reconciliation method,” and provides a list and adjustments for net income to account for items that affected net income but not cash.<sup>8</sup> Such differences make it difficult to make comparisons across financial statements and budgetary documents and public and private institutions.

<sup>5</sup> Table taken nearly verbatim from: Goldstein and Menditto, Op. cit.

<sup>6</sup> Ibid.

<sup>7</sup> Ibid.

<sup>8</sup> Lohrey, Op. cit.

**Figure 1.2: Differences in FASB and GASB Reporting and Display**

DESCRIPTION	FASB	GASB
MD&A	No requirement	Required supplementary information
Disaggregation	<ul style="list-style-type: none"> <li>• Allowable by line of business</li> <li>• Allowable by net asset class</li> </ul>	<ul style="list-style-type: none"> <li>• Only allowable by line of business</li> <li>• Not allowable by net asset class</li> </ul>
Balance Sheet Display	<ul style="list-style-type: none"> <li>• No classified display requirement</li> <li>• Three net asset classes that differ from GASB: <ul style="list-style-type: none"> <li>• Unrestricted</li> <li>• Temporarily restricted</li> <li>• Permanently restricted</li> </ul> </li> <li>• Net assets are displayed for each of the three classes</li> <li>• No special requirements for capital asset display</li> </ul>	<ul style="list-style-type: none"> <li>• Requires a classified balance sheet <ul style="list-style-type: none"> <li>• Current</li> <li>• Noncurrent</li> </ul> </li> <li>• Three net asset classes that differ from FASB <ul style="list-style-type: none"> <li>• Capital assets, net of related debt, separately display: <ul style="list-style-type: none"> <li>○ Non-depreciable</li> <li>○ Depreciable</li> </ul> </li> <li>• Restricted <ul style="list-style-type: none"> <li>○ Expendable</li> <li>○ Non-expendable</li> </ul> </li> <li>• Unrestricted</li> </ul> </li> <li>• Display of unrestricted net asset designations is prohibited</li> </ul>
Cash Flow Statement	<ul style="list-style-type: none"> <li>• Indirect method allowed</li> <li>• Three categories <ul style="list-style-type: none"> <li>• Operating</li> <li>• Investing</li> <li>• Financing</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Direct method mandated</li> <li>• Must reconcile operating cash to net loss from operations per Statement of Revenues Expenses and Changes in Net Assets</li> <li>• Four categories <ul style="list-style-type: none"> <li>• Operating</li> <li>• Investing</li> <li>• Capital and related financing</li> <li>• Noncapital financing</li> </ul> </li> </ul>
Activities Statement	<ul style="list-style-type: none"> <li>• All expenses are unrestricted</li> <li>• Operating measure is optional and self-defined</li> <li>• Expense categories <ul style="list-style-type: none"> <li>• Functional required with prescribed allocations (display or notes) <ul style="list-style-type: none"> <li>○ Depreciation</li> <li>○ O&amp;M of plant</li> <li>○ Interest</li> </ul> </li> <li>• Natural is allowed</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Expenses among net asset classes</li> <li>• Operating measure is required and prescriptive</li> <li>• Expenses categories <ul style="list-style-type: none"> <li>• Allows natural or functional with lack of prescriptive allocations <ul style="list-style-type: none"> <li>○ Depreciation allocation optional</li> <li>○ O&amp;M of plant is separate function</li> <li>○ NACUBO guidance encourages both natural and functional in the notes</li> </ul> </li> </ul> </li> </ul>

Source: NACUBO<sup>9</sup><sup>9</sup> Table taken nearly verbatim from: Goldstein and Menditto, Op. cit.



### BLANK SLATE PROJECT

At the 2014 NACUBO Higher Education Accounting Forum, four members of the Accounting Principles Council presented information about the Blank Slate Project (BSP). The BSP is a new initiative that aims to address the “split industry” issue with FASB and GASB reporting for higher education. It is based on the idea of what an accountant might design for financial reporting in a college or university if they were starting from scratch.<sup>10</sup> The BSP is focused on “an institution's resources and describing how resources are used or conserved for a future period.”<sup>11</sup> The Blank Slate approach includes four statements:

- A balance sheet;
- Income statement;
- Statement of changes in resources; and,
- Statement of cash flows.

However, the BSP developers quickly point on that “these statements are not required and, in fact, do not meet all the requirements of generally accepted accounting principles (GAAP). Rather, they are a means by which higher education can explain its unique qualities and needs to the standard-setting boards and other financial statement users.”<sup>12</sup> These statements are intended to show the distinctive considerations of accounting in higher education to the FASB, GASB, and other financial statement users in hopes of reuniting the GAAP standards for higher education. **NACUBO’s Accounting Principles Council has been meeting with both FASB and GASB in 2013 and 2014 to discuss changes to reporting requirements that would allow for standardization in the education industry.**<sup>13</sup>

### HIGHER EDUCATION BUDGET MODELS

According to a 2011 survey of higher education business officers by *Inside Higher Ed*, there are five main budget models being used by colleges and universities:<sup>14</sup>

- Formula budgeting;
- Incremental budgeting;

<sup>10</sup> Craig, K., and S. Menditto. “Reporting Reimagined.” *Business Officer Magazine*, January 2014. National Association of College and University Business Officers. [http://www.nacubo.org/Business\\_Officer\\_Magazine/Magazine\\_Archives/January\\_2014/Reporting\\_Reimagined.html](http://www.nacubo.org/Business_Officer_Magazine/Magazine_Archives/January_2014/Reporting_Reimagined.html)

<sup>11</sup> “Toward Clarity in Reporting.” *Business Officer Magazine*, September 2013. National Association of College and University Business Officers. [http://www.nacubo.org/Business\\_Officer\\_Magazine/Magazine\\_Archives/September\\_2013/Setting\\_the\\_Pace\\_in\\_Indy/Toward\\_Clarify\\_in\\_Reporting.html](http://www.nacubo.org/Business_Officer_Magazine/Magazine_Archives/September_2013/Setting_the_Pace_in_Indy/Toward_Clarify_in_Reporting.html)

<sup>12</sup> *Ibid.*

<sup>13</sup> Kvall, K, et. al. “Accounting Principles Council Update.” NACUBO 2014 Higher Education Accounting Forum. <http://www.nacubo.org/Documents/APC%20Update.pdf>

<sup>14</sup> Green, K., S. Jaschik, and D. Lederman. “The 2011 Inside Higher Ed Survey of College and University Business Officers.” *Inside Higher Ed*. p. 17. <http://www.insidehighered.com/download/?file=insidehigheredcfosurveyfinal7-5-11.pdf>

- Performance-based budgeting;
- Revenue Center Management; and,
- Zero-based Budgeting.

As presented in Figure 1.3, the most popular budget model among all institutions is the incremental model, used by over 60 percent of public and private higher education institutions. In public institutions, the second most common budget model is the formula model. In private institutions, zero-based budget modeling is the second most common approach. There is also substantial variation in the budget models used by different classifications of institutions, such as doctoral, master's, or baccalaureate institutions. For example, 48 percent of private doctoral universities use the RCM model, but only 12 percent of private master's institutions use this approach.<sup>15</sup>

**Figure 1.3: Budgets Model Used At Higher Education Institutions in 2010-2011 Academic Year (Percentages by Sector)**

BUDGET MODEL USED AT YOUR INSTITUTION DURING THE 2010-2011 ACADEMIC YEAR	FORMULA	INCREMENTAL	PERFORMANCE-BASED	RCM	ZERO-BASED BUDGETING
<b>All Institutions</b>	<b>26.1</b>	<b>60.2</b>	<b>19.6</b>	<b>14.2</b>	<b>30.0</b>
<b>Public Institutions</b>	<b>34.8</b>	<b>59.3</b>	<b>21.0</b>	<b>11.8</b>	<b>25.6</b>
Doctoral Universities	44.7	78.7	25.5	21.3	0.0
Master's Institutions	25.0	73.8	19.6	8.9	16.1
Baccalaureate Colleges	31.0	72.4	17.2	20.7	13.8
Associate/Community Colleges	35.8	47.4	20.8	8.7	37.6
<b>Private/Non-Profit Institutions</b>	<b>17.1</b>	<b>62.3</b>	<b>18.2</b>	<b>17.1</b>	<b>33.2</b>
Doctoral Universities	16.0	56.0	24.0	48.0	20.0
Master's Institutions	14.8	71.6	14.8	12.3	25.9
Baccalaureate Colleges	17.4	58.4	19.1	15.2	37.6

Source: Green, Jaschik, and Lederman<sup>16</sup>

\*Numbers may total more than 100 percent because some institutions may use more than one budget model.

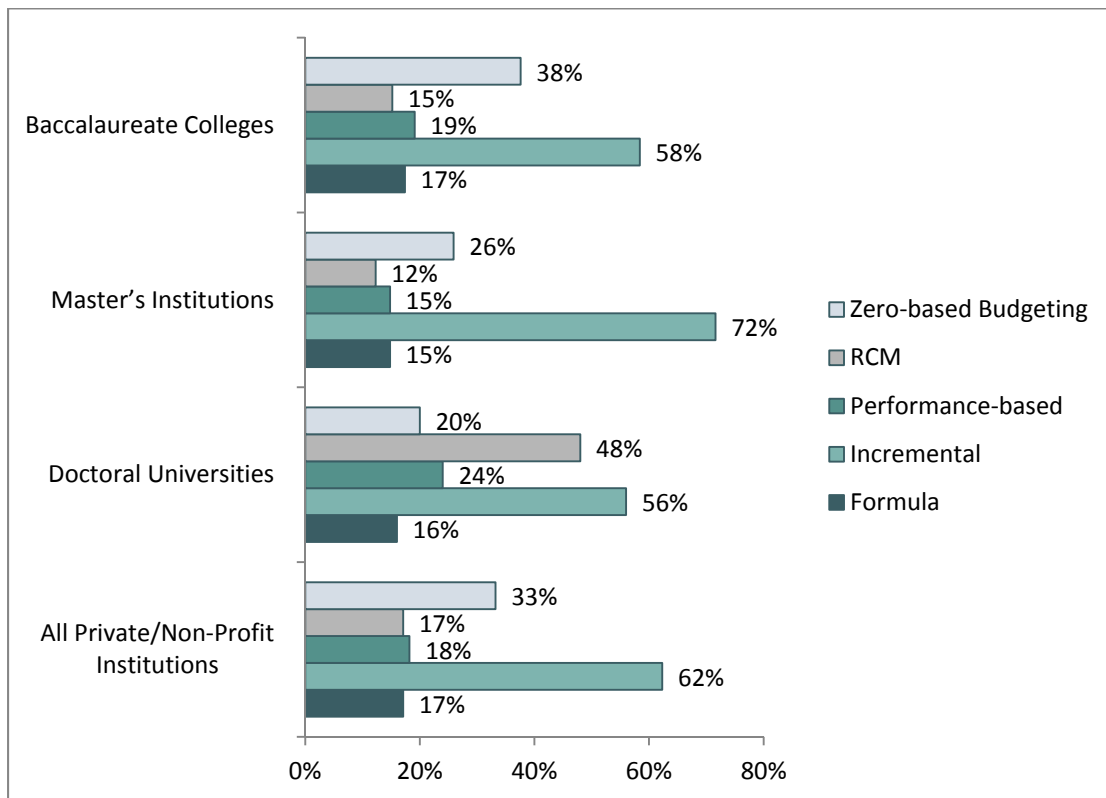
At private baccalaureate colleges, the incremental budget model is the most common (58.4%), followed by zero-based budget modeling (37.6%). Revenue center management is the least common budget model among private baccalaureate colleges. Formula-based budgeting is more common at private baccalaureate colleges than any other type of private institution, but is used far less frequently than it is in public institutions. Figure 1.4 on the follow page presents the budget models used at private institutions in 2011 according to *the Inside Higher Ed* survey.<sup>17</sup>

<sup>15</sup> Ibid.

<sup>16</sup> Ibid.

<sup>17</sup> Ibid.

**Figure 1.4: Budgets Model Used At Private Higher Education Institutions in 2010-2011 Academic Year (Percentages by Sector)**



Source: Green, Jaschik, and Lederman<sup>18</sup>

\*Numbers may total more than 100 percent because some institutions may use more than one budget model.

The *Inside Higher Ed* survey also found that less than 50 percent of business officers felt their current budget model was “very effective” for managing resources during good times. Business officers were even more skeptical of their current budget model’s ability to address specific tasks or challenges like managing resources during difficult times, helping set institutional priorities, helping develop business plans for new programs, or helping develop business plans for online activities. They also do not think that financial data is adequately utilized to inform strategic planning and campus decision-making.<sup>19</sup>

The remainder of this section will provide a summary of each budget modeling approach and the benefits and challenges of each.<sup>20</sup> However, it should be noted that universities may use one or a combination of budget models to suit their needs. For example, the Associate Vice President for Finance at the University of Notre Dame explained that the institution used a “primarily centralized” budget process, but also has some responsibility-centered

<sup>18</sup> Ibid.

<sup>19</sup> Ibid., p. 18.

<sup>20</sup> Ibid.

attributes to their budget, especially with some of the graduate and professional programs.<sup>21</sup>

### *FORMULA BUDGETING*

The formula model of budgeting is typically used on a centralized campus, and uses formula calculations to estimate future costs based on selected measures of unit costs and outputs. For example, funding for a department might be determined by the number of students or credit hours in the program and the estimated cost of education per student.<sup>22</sup> Common approaches to resource flow are to either pool the funds, and redistribute them based on the proportional unit shares determined by the formula, or to apply an agreed-upon rate, such as \$100 per credit hour taught to annual unit credit-hour fluctuations.<sup>23</sup>

The formula-based approach can be appealing because it “depoliticizes” the appropriation of funding by using quantitative measures to determine funding distributions.<sup>24</sup> This budget model incorporates data to justify funding decisions, and is usually easy to understand.<sup>25</sup> On the other hand, formula funding can present issues because “simple formulas may be too simple, program unit costs are not always easy to ascertain, and academic quality considerations (not to mention politics) mediate most any metric design.”<sup>26</sup>

### *INCREMENTAL BUDGETING*

Incremental budgeting is the most common approach for both public and private institutions.<sup>27</sup> It is a top-down approach where a central entity uses the current budget of unrestricted revenues as a “base” that is adjusted based on changing increments like salary inflation, new faculty positions, or other factors to produce the new year’s budget.<sup>28</sup> The rationale behind this approach is that “the institution’s fundamental goals and objectives will not change markedly from this year to the next.”<sup>29</sup>

Incremental budgeting is easy to administer from the individual unit business officer’s perspective and allows central leadership to “steer” the university toward meeting its

<sup>21</sup> Porter, M. “Don’t Be Wedded to Any One Model.” *Business Officer Magazine*, May 2013. National Association of College and University Business Officers.  
[http://www.nacubo.org/Business\\_Officer\\_Magazine/Magazine\\_Archives/May\\_2013/Dont\\_Be\\_Wedded\\_to\\_Any\\_One\\_Model.html](http://www.nacubo.org/Business_Officer_Magazine/Magazine_Archives/May_2013/Dont_Be_Wedded_to_Any_One_Model.html)

<sup>22</sup> “University of Wisconsin-Madison Budget Allocation Model: Past, Present and Possibilities.” University of Wisconsin - Madison. p. 12. <https://www.vc.wisc.edu/documents/Budget-Model-White-Paper.pdf>

<sup>23</sup> Curry, J., A. Laws, and J. Strauss. “The Buck Stops Elsewhere.” *Business Officer Magazine*, January 2013. National Association of College and University Business Officers.  
[http://www.nacubo.org/Business\\_Officer\\_Magazine/Magazine\\_Archives/January\\_2013/The\\_Buck\\_Stops\\_Elsewhere.html](http://www.nacubo.org/Business_Officer_Magazine/Magazine_Archives/January_2013/The_Buck_Stops_Elsewhere.html)

<sup>24</sup> “University of Wisconsin-Madison Budget Allocation Model: Past, Present and Possibilities.” Op. cit.

<sup>25</sup> Curry, Laws, and Strauss, Op. cit.

<sup>26</sup> Ibid.

<sup>27</sup> Green, Jaschik, and Lederman, Op. cit.

<sup>28</sup> Curry, Laws, and Strauss, Op. cit.

<sup>29</sup> “University of Wisconsin-Madison Budget Allocation Model: Past, Present and Possibilities.” Op. cit.

mission or strategic goals.<sup>30</sup> It also allows campus units to plan, since funding is informed in part by the previous year's base budget and typically maintains a unit's relative share of the total expenditures. However, central steering abilities can be limited if base budgets become viewed as entitlements by each unit,<sup>31</sup> and there is little incentive to start new programs or reevaluate how current programs are funded.<sup>32</sup>

### *PERFORMANCE-BASED BUDGETING*

Performance based budgeting is closely related to formula budgeting, with the added factor that the formula inputs are based on "outputs" or performance metrics such as enrollment or research volume to determine funding levels.<sup>33</sup> Units are expected to meet certain performance measures to receive funding, a tactic which can be used to achieve mission goals.

Developing performance metrics can be difficult because of the implied politics of budget allocation based on particular measures and other differences between various academic units, their goals, and operation. Although coming up with the proper metrics can be difficult, once they are established the approach is relatively straightforward. Furthermore, this approach focuses on improving outcomes rather than measuring inputs and processes.<sup>34</sup>

### *REVENUE CENTER MANAGEMENT*

Revenue center management (RCM), also sometimes known as responsibility center management, is a decentralized budget approach that delegates responsibility for expenses and revenue to the various schools, divisions, and other campus units. Each unit is also assigned a portion of government support and is responsible for a portion of the institutions general operating expenses.<sup>35</sup> Under this approach, rather than simply requesting money, deans and directors prepare a budget proposal that:<sup>36</sup>

- Projects their shares of tuition, research, and other revenues;
- Raises issues affecting preliminary estimates of their shares of indirect costs and proposes revisions; and,
- Describes how they would balance their proposed budgets if their allocations of university revenues differed from their current levels (either more or less).

Benefits of RCM include increased engagement of institutional units in the university's finances, with input on relationships among unit budgets, academic outputs like teaching and research, and the role of administrative support services. However, this approach also

<sup>30</sup> Curry, Laws, and Strauss, Op. cit.

<sup>31</sup> Ibid.

<sup>32</sup> "University of Wisconsin-Madison Budget Allocation Model: Past, Present and Possibilities." Op. cit.

<sup>33</sup> Ibid.

<sup>34</sup> Ibid., p. 12-13.

<sup>35</sup> Ibid., p. 13.

<sup>36</sup> Bulleted points taken verbatim from: Curry, Laws, and Strauss, Op. cit.

may cause academic programs to become “budget-driven at the risk of sacrificing academic performance, priorities, and innovation.”<sup>37</sup> For example, a school may develop courses or programs that will generate revenues but are not aligned with the mission and quality of education at the university.<sup>38</sup>

### ZERO-BASED BUDGETING

Zero-based budget modeling is the second most prevalent model among private baccalaureate colleges. Under this approach, the previous year’s budget is zeroed out and every campus unit must re-request and justify all funding. This form of budget preparation is effective for controlling unnecessary costs and discourages a feeling of entitlement to a certain amount of funding each year. Advocates for zero-based budgeting believe that although it requires a substantial time-investment, its increased transparency and accountability are major advantages to this system.<sup>39</sup> However, zero-based budgeting also runs counter to common continuing commitments for universities, such as faculty tenure.<sup>40</sup>

### INTERNAL REPORTING

Internal reporting practices may differ from the scope and breadth of financial information provided in audited reports in higher education. Financial industry experts from KPMG, Prager, Sealy and Co., LLC, and Attain recommend the following key components to be included in internal financial reports for higher education:<sup>41</sup>

- Discussion and analysis of liquidity, capital needs, financial condition and results of operations;
- Use of metrics instead of detailed financial reports;
- Segregating sources of funds between revenues and support (philanthropy and return on philanthropy);
- Reporting expenses by object type based on how institutions budget expenses;
- Articulating the basis of budgeting;
- Providing financial reports with the proper content and frequency; and
- Preparing and interpreting cash flow and liquidity information.

In 2004, NACUBO conducted a survey of 377 private and 285 public institutions on internal financial reporting practices. The survey focused on interim financial statements and

<sup>37</sup> “University of Wisconsin-Madison Budget Allocation Model: Past, Present and Possibilities.” Op. cit.

<sup>38</sup> Curry, Laws, and Strauss, Op. cit.

<sup>39</sup> Porter, M. “Starting from Scratch.” *Business Officer Magazine*, April 2012. National Association of College and University Business Officers.

[http://www.nacubo.org/Business\\_Officer\\_Magazine/Magazine\\_Archives/April\\_2012/Starting\\_from\\_Scratch.html](http://www.nacubo.org/Business_Officer_Magazine/Magazine_Archives/April_2012/Starting_from_Scratch.html)

<sup>40</sup> “University of Wisconsin-Madison Budget Allocation Model: Past, Present and Possibilities.” Op. cit.

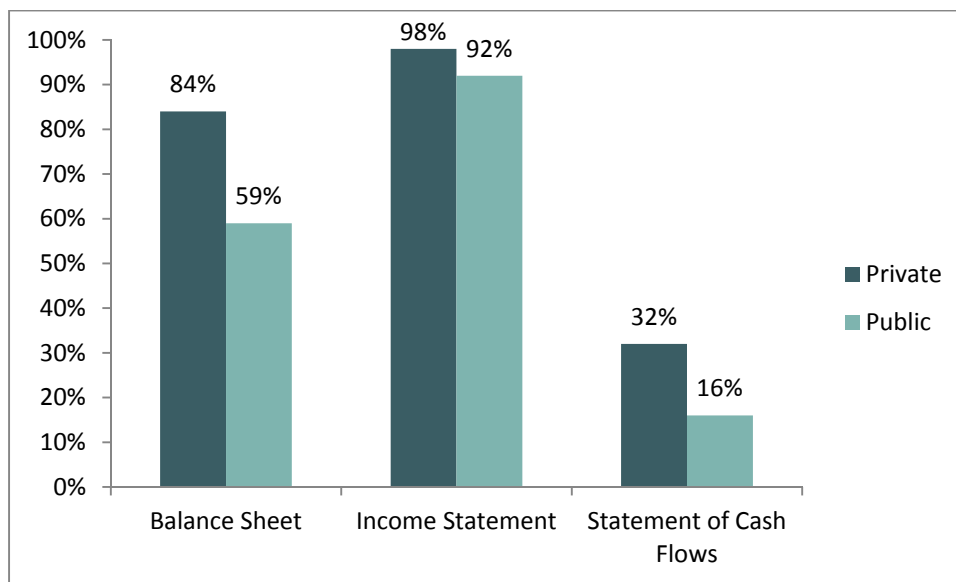
<sup>41</sup> Bulleted points taken verbatim from: “Strategic Financial Analysis for Higher Education: Identifying, Measuring & Reporting Financial Risks.” KPMG, Prager, Sealy and Co., LLC, and Attain, 2010. p. 43.  
[http://policies.medschool.ucsf.edu/sites/policies.medschool.ucsf.edu/files/documents/NSS\\_Handbook.pdf](http://policies.medschool.ucsf.edu/sites/policies.medschool.ucsf.edu/files/documents/NSS_Handbook.pdf)

management reporting practices. **Interim financial statements** are “unaudited institutional level reports that are similar in format to the audited financial statements.”<sup>42</sup> **Management reporting** refers to “both routine and ad hoc financial data used internally for decision making.”<sup>43</sup>

### INTERIM FINANCIAL STATEMENTS

The NACUBO survey revealed that about 65 percent of private institutions and 30 percent of public institutions were preparing interim financial statements. Most often, these were prepared monthly and were originally prompted by the CFO or the Board of Trustees. Among private institutions, these reports are usually provided to the Board of Trustees, the President, the CFO, and banks or financial institutions.<sup>44</sup> As presented in Figure 1.5 below and Figure 1.6 on the following page, income statements and balance sheets are typically included in interim reports for private institutions, and are prepared at the university-wide level.

**Figure 1.5: Which statements are you producing for your interim reports?**



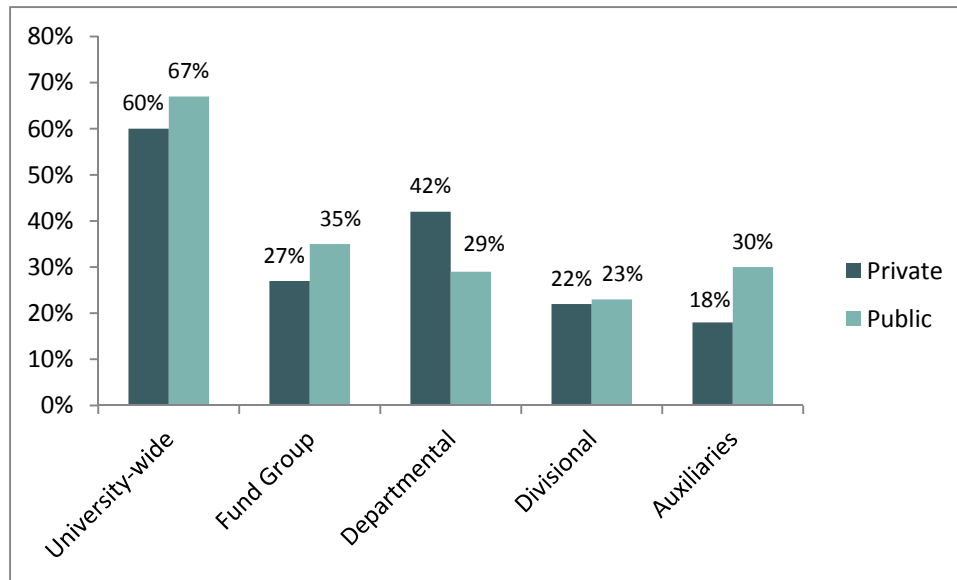
Source: NACUBO<sup>45</sup>

<sup>42</sup> “NACUBO Internal Financial Reporting Survey.” NACUBO. 2004. p. 1.  
<http://www.nacubo.org/documents/IFRSurveyResults.pdf>

<sup>43</sup> *Ibid.*, p. 3.

<sup>44</sup> *Ibid.*, p. 1.

<sup>45</sup> *Ibid.*, p. 2.

**Figure 1.6: At what level are you providing interim reports?**

Source: NACUBO<sup>46</sup>

### MANAGEMENT REPORTING

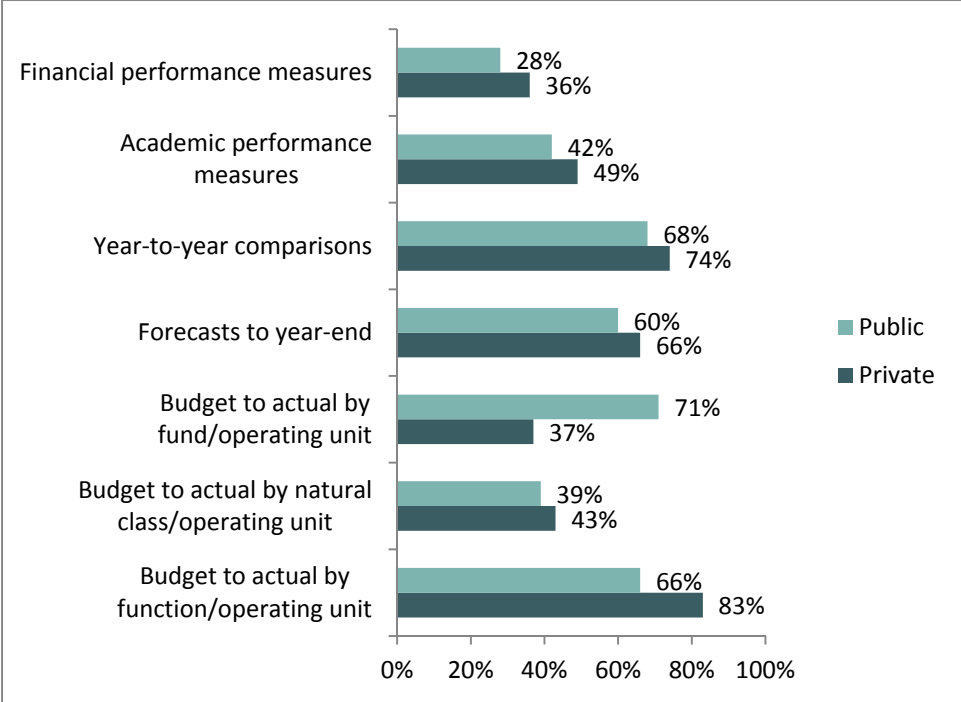
**About 83 percent of private institutions and 79 percent of public institutions surveyed were preparing management reports on an ongoing basis.** Most institutions have been producing such reports for over 5 years and deliver reports to the President, CFO, and to a lesser extent, deans and department heads.<sup>47</sup> Figure 1.7 on the following page presents the key metrics and ratios that are typically included in management reports. For private institutions, the most common metric is “budget to actual by function/operating unit,” while among public institutions the most common metric is “budget to actual by fund/operating unit.”

<sup>46</sup> Ibid., p. 1.

<sup>47</sup> Ibid., p. 3.



Figure 1.7: What are the key figures, metrics or ratios on the management report?



Source: NACUBO<sup>48</sup>

<sup>48</sup> Ibid.

## SECTION II: CONSIDERATIONS FOR REPORTING WITHIN PUBLIC AND PRIVATE SPHERES

In addition to the difference in FASB and GASB reporting for private and public higher education institutions, institutions also differ in how they report within the FASB and GASB guidelines. As one University of California faculty member explained, “When you wade into those financial reports, you should understand that the numbers are invariably correct. What you need to be skeptical about are the words and labels attached to the numbers.”<sup>49</sup> How institutions classify financial data within reports can result in significantly different data being presented under similar headings.

In this section, Hanover draws on excerpts from higher education budget to illustrate the differences in reporting across institutions. After examining differences among private and public institutions, this section also presents information on financial reporting software used by higher education institutions as well as fundraising reporting.

### PRIVATE INSTITUTIONS

At the NACUBO Higher Education Accounting Forum in 2013, the National Industry Director for Higher Education at KMPG, Lou Mezzina, presented a review of trends in financial statements among private colleges and universities of all sizes based on 2011 and 2012 audited financial statements. He noted trends in different aspects of financial reports, including the statement of financial position, statement of activities, endowment return reporting, statement of cash flows, and use of footnotes.<sup>50</sup>

Within the **statement of financial position**, about 10 percent of statements noted use of a “Balance Sheet,” and 5 percent noted a “classified” presentation. About 20 percent of financial statements disaggregated items under net assets to some degree, and Mezzina noted that many reports had the opportunity to reduce the number of line items to present information more effectively.<sup>51</sup>

For the **statement of activities**, the most common format used was columnar by net asset category, with only the total for the previous year as a full columnar or a separate page. Only about 10 percent of statements of activities used the single column or “pancake” style format. Almost all statements distinguished operating from non-operating expenses; however, how institutions defined “non-operating” varied widely from report to report.

<sup>49</sup> Schwartz, C. “So You Want to Examine Your University’s Financial Reports?” *The Chronicle of Higher Education*, February 7, 2012. <http://chronicle.com/article/So-You-Want-to-Examine-Your/130672/>

<sup>50</sup> See slides in presentation, available online, for extensive examples of variations on reporting in private universities from: Mezzina, L. “Financial Statements Review of private Colleges and Universities.” NACUBO Higher Education Accounting Forum. May 20, 2013. <http://www.nacubo.org/Documents/EventsandPrograms/2013HEAF/Financial%20Statement%20Review-Private.pdf>

<sup>51</sup> *Ibid.*, p. 5.

Finally, Mezzina noted a growing trend toward presenting expenses by natural classification on the statement face, with about 15 percent using this format. In reports that presented expenses by function, they included disclosure by natural classification.<sup>52</sup>

Mezzina notes that for **endowment return accounting and reporting**, universities typically reported in a few different ways. He provided the following illustrative example of three different ways of reporting the same information:

**Assume the following:**

- A New University is endowed with a \$100 million permanently restricted gift intended to provide unrestricted operating support of \$5 million beginning in the school's first year 20X1
- Investment return in 20X1 is 20% or \$20 million
- Investment return in 20X2 is a negative \$4 million

Given this information, a university might report its endowment return in the following ways, presented in Figure 2.1 on the following page. Note that year 20X1 remains the same in each example, and year 20X2 changes.

**Figure 2.1: Three Versions of Endowment Return Reporting**

20X1 (YEAR 1, REMAINS UNCHANGED)	UNRESTRICTED	TEMP. RESTRICTED	PERM. RESTRICTED	TOTAL
Operating Revenue: Endowment payout/Investment return appropriated	\$5,000	-	-	\$5,000
Nonoperating activity: Endowment return in excess of payout	-	\$15,000	-	\$15,000
20X2 (OPTION A)	UNRESTRICTED	TEMP. RESTRICTED	PERM. RESTRICTED	TOTAL
Operating Revenue: Endowment payout/Investment return appropriated	\$5,000	-	-	\$5,000
Nonoperating activity: Endowment return/Investment return less than payout/amount appropriated	-	(\$9,000)	-	(\$9,000)
20X2 (OPTION B)	UNRESTRICTED	TEMP. RESTRICTED	PERM. RESTRICTED	TOTAL
Operating revenue: Net assets released from restriction	\$5,000	(\$5,000)	-	-
Nonoperating activity: Endowment/Investment return	-	(\$4,000)	-	(\$4,000)
20X2 (OPTION C)	UNRESTRICTED	TEMP. RESTRICTED	PERM. RESTRICTED	TOTAL
Operating revenue: Net assets released from restriction	\$5,000	-	-	\$5,000
Nonoperating activity: Net assets released from restriction	-	(\$5,000)	-	(\$5,000)
Endowment/Investment return	-	(\$4,000)	-	(\$4,000)

Source: Mezzina<sup>53</sup>

<sup>52</sup> Ibid., p. 14.

In the **statement of cash flows**, Mezzina notes that nearly all schools used the indirect method. Among private institutions, the most notable item that is reported differently across institutions is the “change in funds held by bond trustee,” which are classified either as investing or financing.<sup>54</sup>

Within **footnotes**, the scope and depth of information provided in miscellaneous disclosures under the headings of “the organization” and the “nature of operations” varied greatly. For Income Tax Disclosures, footnotes vary from a single sentence to a paragraph. Institutions typically include footnotes for miscellaneous disclosures such as liquidity, advertising costs, or a variety of other items, as well as income tax disclosures, investment disclosures, endowment disclosures, pension and postretirement disclosures, related-party disclosures, and expense disclosures.<sup>55</sup>

Karen Craig and Sue Menditto, members of the NACUBO Accounting Principles Council and the Blank Slate Project, point out that “disclosure overload” has been a rising concern among business officers at both public and private universities. They suggest that footnotes should provide additional information that is most relevant to financial statement users, such as liquidity, investment maturity schedules, how students pay for college, financial aid, and mission-related expenses. Craig and Menditto, along with the Blank Slate Project, suggest the following guidelines for ordering and presenting footnotes:<sup>56</sup>

- Order the notes to follow the lines on the financial statements, starting with the balance sheet.
- Include policy disclosures with the relevant note (for example, accounting policy for investments included in the investments footnote).
- Place at the end of the notes section accounting policies for which there is no separate footnote (use of estimates, tax status, and so on).

See Figure A.1 in the Appendix to this report for further examples from the Black Slate Project regarding sample footnote disclosures for liquidity, endowment, student income, and financial aid.

## PUBLIC INSTITUTIONS

Public institutions prepare financial statements according to GASB standards, but also use financial statements for reporting key ratios, debt ratings, and interim financial reporting.<sup>57</sup> Financial statements typically include a letter of transmittal, management’s discussion and

<sup>53</sup> Ibid., pp. 23-26.

<sup>54</sup> Ibid., p. 27.

<sup>55</sup> See slides for examples of each type of disclosure used in financial statements at private institutions: Ibid., pp. 27-71.

<sup>56</sup> Bulleted points taken verbatim from: Craig and Menditto, Op. cit.

<sup>57</sup> VanDenBerg, V. and P Brenzing. “Public Institution Financial Statements: The Good, the Bad, and the Ugly.” NACUBO Conference, April 29, 2014. p. 3.  
<http://www.nacubo.org/Documents/Financial%20Statement%20Review%20-%20Public.pdf>

analysis (MD&A), statements of net position, revenues, expenses, and changes in net position, cash flows, and footnotes.

Including an **MD&A** can be very beneficial to financial statement users when executed effectively. This section is a narrative description of the following detailed financial statement that is intended to tell your “business story” through a concise summary of key points.<sup>58</sup> It should include trend information that guides the reader in understanding the overall implications of the financial information and should also be creative and engaging. Common pitfalls for MD&A discussion are awkward wording, including too many statistics, and struggling to summarize a large amount of information effectively.<sup>59</sup> Accounting experts from Plante and Moran, PLLC and Grand Valley State University suggest the following strategies for an effective MD&A:

- Be concise and stick to the main message.
- Graphs can tell your story with minimal words.
- Include strategic information that the Board or public will want to know, such as enrollment, state appropriations, capital plans, endowment growth and support, and debt.

In the actual financial and budget documents, reporting formats may vary by institution and state. This can make benchmarking efforts very difficult, as it is hard to tell if institutions are comparing “apples to apples.” For example, Elizabeth Capaldi and Craig Abbey, administrators at Arizona State University and University of Buffalo, SUNY respectively, point out that:<sup>60</sup>

Budgets vary by discipline...since both teaching and research are structured differently by discipline. So the appropriate comparison is between disciplines, not between universities. In the for-profit business world, this is akin to conglomerate corporations comparing their performance by benchmarking their individual business lines against performance in the sectors in which they each operate and compete.

There are also differences in how states operate that make comparisons across states difficult if not impossible. In New York, for example, the state pays fringe benefits and debt service directly for SUNY institutions, so those dollars never show up in the universities budgets; in Arizona each university pays these costs out of its operating budget. While these dollars show up in IPEDS reporting, Arizona's represent actual expenditures while New York's represent estimated amounts, since the state does not track these expenditures separately.

In addition, different universities apply different rules for answering the same questions on the same forms. For example, IPEDS collects faculty data on the

<sup>58</sup> Ibid., p. 7.

<sup>59</sup> Ibid., p. 8.

<sup>60</sup> Capaldi, E, and C. Abbey. “Performance and Costs in Higher Education: A Proposal for Better Data.” *Change: The Magazine of Higher Learning*, March-April 2011.  
<http://www.changemag.org/Archives/Back%20Issues/2011/March-April%202011/better-data-full.html>

Human Resources survey. In the past, it did so in three annual surveys: the IPEDS Instructional Staff/Salaries, IPEDS Employees by Assigned Position, and IPEDS Fall Staff...[F]or “instructional faculty” some institutions report all full-time ranked faculty, some include lecturers and some do not, some include only those paid 50 percent or more by state funds, and some define them as whoever is teaching (Gater & Lombardi, 2001). Some land-grant institutions consider their extension agents to be faculty members and report them as such, while others do not.

Within the GASB guidelines, there is some flexibility in how institutions chose to report their financial data. For example, operating expenses can be displayed as either object or natural classifications (salaries, benefits, depreciation, etc.) or functional classifications (instruction, research, institutional support). This affects the presentation of this data in financial statements. While the FASB allows either classification as well, it requires that the alternate format be presented in the notes to the statement. For example, if an institution used the natural classification in the statement of activities, it would have to present the same information using the functional classification in the footnotes.<sup>61</sup>

## FINANCIAL REPORTING SOFTWARE

According to a survey conducted by Educause in 2011, there were 31 providers for financial software in higher education at 628 institutions. Nineteen financial application providers, or 61 percent, were being used at fewer than four institutions in 2011. The top five providers accounted for about 82 percent of the total market, as presented in Figure 2.2.<sup>62</sup>

**Figure 2.2: Market Share of Top 5 Financial Application Providers**

PROVIDER	MARKET SHARE
Oracle	31%
SunGard Higher Education	30%
Datatel Colleague Financials	13%
Jenzabar	5%
SAP ERP Financials	3%
<b>Total</b>	<b>82%</b>

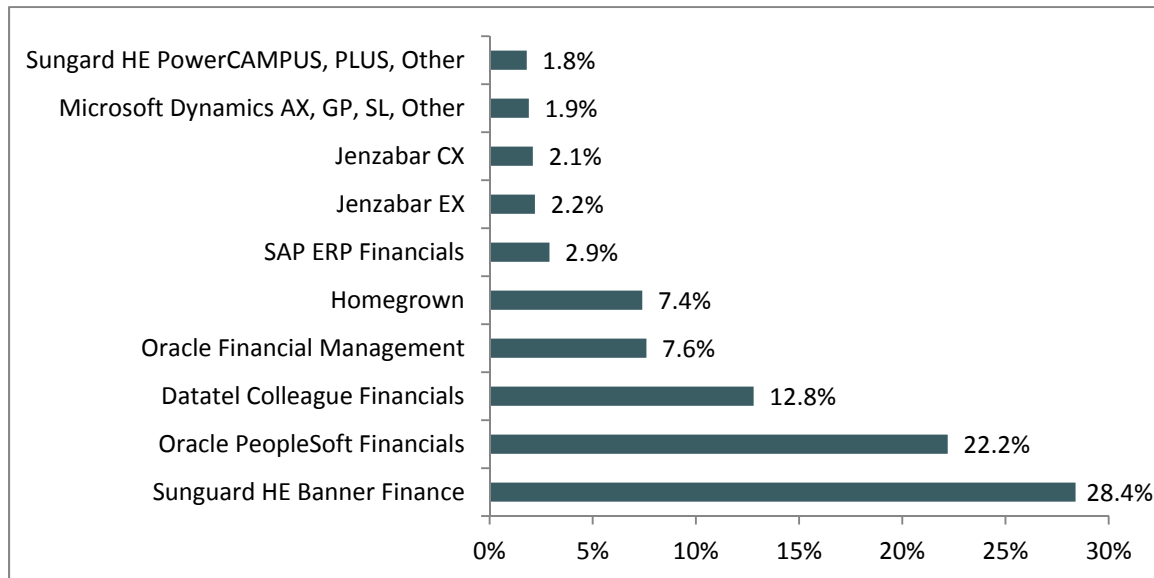
Source: Educause<sup>63</sup>

Figure 2.3 presents the distribution of market share among the top 10 financial software packages. “Homegrown” refers to internally developed applications. Sungard HE Banner Finance and Oracle PeopleSoft Financials dominate the market with almost 50 percent of the market share.

<sup>61</sup> Goldstein and Menditto, Op. cit.

<sup>62</sup> Grajek, S., L. Lang, and D. Trevett. “The 2011 Enterprise Application Market in Higher Education.” Educause Center for Applied Research. June 2012. p. 14. <http://net.educause.edu/ir/library/pdf/ers1206/ers1206.pdf>

<sup>63</sup> Ibid., p. 14.

**Figure 2.3: Financial Management Applications Used by Higher Education Institutions in 2011**

Source: Educause<sup>64</sup>

## FUNDRAISING REPORTING

In this section, Hanover explores the reporting and metrics used by three universities to measure advancement and fundraising efforts, based on a presentation by the fundraising directors at Williams College, the University of Tennessee, and the University of Missouri.<sup>65</sup> These metrics are used to:<sup>66</sup>

- Measure fundraising performance,
- Measure and forecast campaign performance;
- Facilitate movement of prospects; and,
- Evaluate caseloads.

However, on a larger scale, some institutions publish an annual fundraising report that provides the “big picture” aspects of fundraising. These reports typically include narrative descriptions of fundraising efforts and present trend data that track fundraising progress over time.<sup>67</sup> Metrics might include gifts by source, gifts by type, gifts by discipline, and longitudinal trends in total fundraising.

<sup>64</sup> Ibid., p. 13.

<sup>65</sup> Kleinschmidt, L. T. Borne, and M. Reopell. “Advance and Fundraising Metrics.” Sungard Summit 2007. <http://www.suu.edu/it/admin/summit2007/cdsite/color/Advancement/1158/1158.pdf>

<sup>66</sup> Ibid., p. 4.

<sup>67</sup> See for example: [1] “Annual Report on University Private Support: 2012-2013.” University of California. [http://www.ucop.edu/institutional-advancement/\\_files/annual-reports/2013.pdf](http://www.ucop.edu/institutional-advancement/_files/annual-reports/2013.pdf)

[2] “Fundraising Survey Report, Fiscal year 2010-2011.” The State University of New York. <https://www.suny.edu/media/suny/content-assets/documents/philanthropy/2010-11-Fundraising-Survey-Report.pdf>

[3] “Annual Report 2012-2013.” Occidental College. pp. 20-26.

### *WILLIAMS COLLEGE*

Williams College is a top liberal arts college with about 2,000 students enrolled. In 2007, the advancement office at the college employed 75 FTE staff and was working toward a \$400 million campaign goal. Williams College used three metrics-based reports to track progress in fundraising: major gift prospects by region, prospect status summary, and prospect moves.<sup>68</sup>

For the report of **major prospects by region**, reporting metrics recorded totals in each region, the completed number and percentage, total prospect dollars, prospects in the pipeline, and outstanding prospects.<sup>69</sup> The **prospect status summary** report captured metrics for stage distribution, including prospect distribution by gift amount, the stage of distribution, and totals. Finally the **prospect moves** report captured final results for fundraising. This report presented the following metrics:<sup>70</sup>

- Number of prospects, travel, visits, and stewardship;
- Solicitations for the report period;
- Proposals closed for the report period;
- Major prospect dollars asked for by month, fiscal year (FY), and cumulative to date (CTD);
- Realized gifts for month, FY, and CTD; and,
- CTD yield rate.

The director of advancement at Williams College also recommends that institutions consider a number of other metrics for fundraising, depending on the institution's goals and initiatives. Some proposed fundraising metrics to consider are annual growth of donors, annual growth of dollars, prospect to gift time, percent participation, percent of gifts online, expected maturity of deferred gifts, dollars raised per FTE staff, cost per dollar raised, trustee/board giving, and trustee/board retention.<sup>71</sup>

### *UNIVERSITY OF TENNESSEE*

The University of Tennessee (UT) is a large public university system with four campuses and about 42,000 students enrolled across the state. In 2007, the Development and Alumni Affairs unit employed 204 full-time equivalent staff, with over 50 development officers.<sup>72</sup> They began using metrics in the mid-2000s for **unit analysis reports** measuring campaign

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[http://issuu.com/occidentalcollege/docs/2013\\_annual\\_report\\_0fe79d144b624e?e=3611317/5329728](http://issuu.com/occidentalcollege/docs/2013_annual_report_0fe79d144b624e?e=3611317/5329728)  
[4] "Johnson County Community College Foundation Fundraising Finance Report." Johnson County Community College Foundation, 2012. <http://www.jccc.edu/files/pdf/foundation/fundraising-finance-report.pdf>

<sup>68</sup> Ibid., p. 24.

<sup>69</sup> Ibid., pp. 25-26.

<sup>70</sup> Ibid., p. 29.

<sup>71</sup> Ibid., p. 32-33.

<sup>72</sup> Ibid., p. 6.



progress and activity levels by unit and **development activity reports** measuring activity of individual development officers.

Metrics for the unit analysis report included cumulative gifts booked by gift type and gift source, and quarterly staff activity measurements for personal visits, solicitations and proposal development, contact type, total prospects under management, and total new prospects for the quarter. For staff activity measurements, each metric was assigned a “goal” value and an “actual” value.<sup>73</sup> Development activity reports were also produced quarterly, measuring personal visits, proposals submitted, contact type, total prospects under management, and total new prospects by employee.<sup>74</sup>

### *UNIVERSITY OF MISSOURI*

The University of Missouri (Mizzou) is a large public research institution with about 29,000 students. In 2007, the Advancement unit employed about 140 FTE staff. The unit was working toward meeting a \$1 billion campaign goal. The Director of Advancement noted that the fundraising reports used changed as the fundraising campaign progressed. Early in the process, they focused on prospects logs and narrowing the list to remaining prospects, later reports focused on moving prospect status and proposed strategies, and in the final stages of the campaign, reporting focused on closing gifts.<sup>75</sup>

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<sup>73</sup> Ibid., pp. 8-9.

<sup>74</sup> Ibid., p. 11.

<sup>75</sup> Ibid., pp. 14-22.

## SECTION III: KEY PERFORMANCE INDICATORS

### HIGHER LEARNING COMMISSION RATIOS

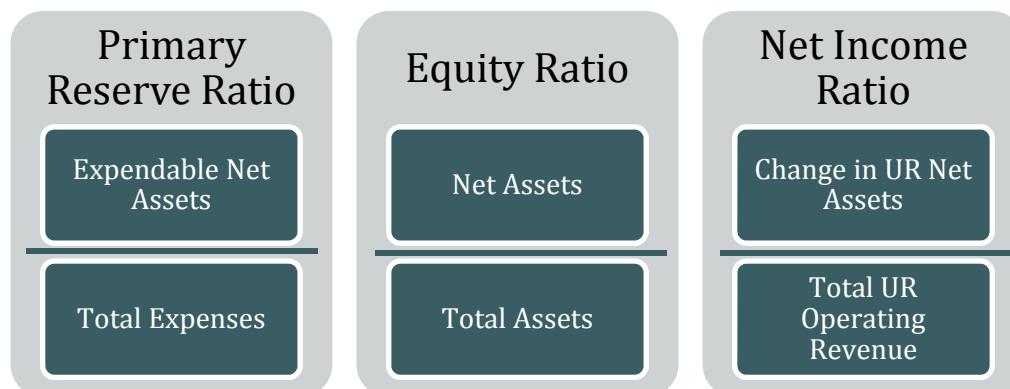
The Higher Learning Commission (HLC) ratios can be used by higher education institutions to create comparable charts for benchmarking with peer institutions. They can also be used for internal benchmarking efforts to establish targets with the Board and administrators.<sup>76</sup> These ratios can help an institution answer questions like:<sup>77</sup>

- Are financial resources sufficient to support the institution’s mission?
- Is the institution clearly financially healthy or not as of the balance sheet date?
- Is the institution financially better off or not at the end of the year than it was at the beginning?
- Did the institution live within its means or not during the year?

### PRIVATE INSTITUTION RATIOS

There are three main HLC ratios for private institutions: primary reserve ratio, equity ratio, and net income ratio.<sup>78</sup> The primary reserve ratio addresses how long an institution could potentially operate with its expendable reserves. The equity ratio assesses the proportion of assets that the institution owns. Finally, the net income ratio assesses if unrestricted activities resulted in a surplus or a deficit. The calculations for each ratio are presented below in Figure 3.1.

**Figure 3.1: HLC Ratios for Private Institutions**



Source: Miller<sup>79</sup>

<sup>76</sup> VanDenBerg and Brenzing, Op. cit., p. 33.

<sup>77</sup> Miller, S. “The Higher Learning Commission Financial Indicators Workshop.” Higher Learning Commission Annual Meeting, 2007. <http://www.ncahlc.org/download/annualmeeting/07Handouts/GMON1045I.pdf>

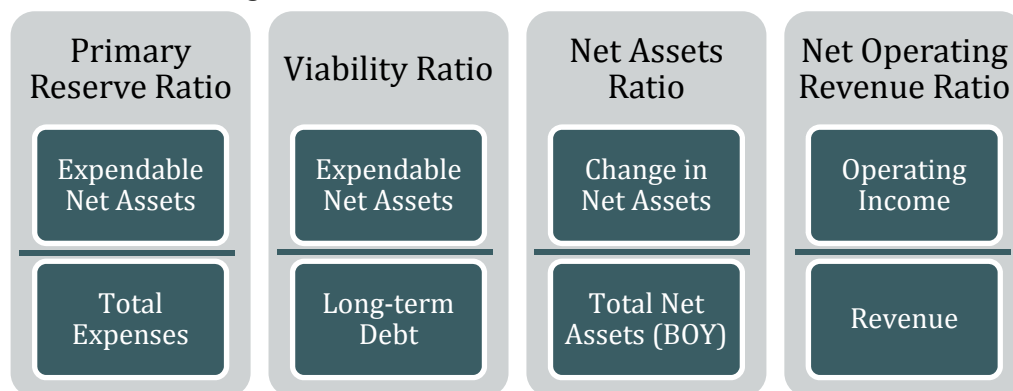
<sup>78</sup> Ibid., pp. 2-3.

<sup>79</sup> Ibid.

**PUBLIC INSTITUTION RATIOS**

Public institutions have a different set of HLC ratios that can be used to evaluate financial wellbeing for the institution. The four HLC ratios for public institutions are: primary reserve ratio, viability ratio, return on net assets ratio, and net operating revenue ratio. The first ratio of primary reserve serves the same function at public institutions as at private. The viability ratio measures the amount of expendable net assets that would be available to pay off debt at any given time. The return on net assets ratio measures returns on net asset investments for the year, and the net operating revenue ratio assesses whether operating activities provided a surplus or deficit for the year. Figure 3.2 presents the calculations for each ratio.

**Figure 3.2: HLC Ratios for Private Institutions**



Source: Miller<sup>80</sup>

**STRENGTH FACTOR**

Once the ratios have been calculated, they are converted to a “strength factor” on a scale of one to 10, where a score of one indicates financial stress and a score of 10 suggests strong financial health.<sup>81</sup> NACUBO provides conversion rates to help universities determine their strength factors for each ratio, as presented in Figure 3.3. The ratio divided by the conversion factor yields the strength factor.<sup>82</sup>

**Figure 3.3: Conversion Rates for Strength Factors**

RATIO	CONVERSION FACTOR
Primary Reserve Ratio	0.133
Net Income Ratio - Operating	0.70%
Net Income Ratio - Change	1.3%
Return on Net Assets	2.0%
Viability Ratio	0.417

Source: NACUBO<sup>83</sup>

<sup>80</sup> Ibid.

<sup>81</sup> Ibid., p. 5.

<sup>82</sup> “Key Benchmarks.” NACUBO 2013 Planning and Budgeting Forum. September 17, 2013. p. 16. <http://www.nacubo.org/Documents/EventsandPrograms/2013PBF/NACUBO%20Key%20Benchmarks%20Presentation%20091713.pdf>

<sup>83</sup> Ibid.

Strength factors are then weighted based on an institution's long-term debt status, and calculated to produce the Composite Financial Index (CFI). The ratios and strength factors are often converted into graphic format to illustrate the financial profile of an institution.<sup>84</sup>

### OTHER KEY PERFORMANCE INDICATORS

NACUBO also identifies a number of other common key performance indicators (KPIs) typically used by institutions to measure various financial factors for strategic planning and benchmarking purposes. These are presented in Figure 3.4 below.

**Figure 3.4: Common Financial KPIs**

KPI	CALCULATION	MEASURES
<b>Secondary Reserve Ratio</b>	$\frac{\text{Non-expendable net assets}}{\text{Total expenses}}$	Significance of permanently restricted net assets. No recommended level, but higher is better.
<b>Net Tuition by Student FTE</b>	$\frac{\text{Net tuition and fees}}{\text{FTE students}}$	Average tuition and fees actually received per student. When compared to prior years and published rates, it reflects the institution's success in retaining its annual tuition and fee increases.
<b>Net Education by Student FTE</b>	$\frac{\text{Education and general expense}}{\text{FTE students}}$	Average educational expenses incurred per student. When compared to prior years and new tuition per FTE, it reflects the institution's success limiting cost increase and living within its means.
<b>Debt Coverage Ratio</b>	$\frac{\text{Adjusted change in net assets}}{\text{Debt service}}$ (Adjusted Change in Net Assets= Change in unrestricted net assets + depreciation expense + interest expense; Debt service= Principal payments + interest expense)	Income available to service debt service payments. No recommended level but higher is better.
<b>Tuition Discount Rate</b>	$\frac{\text{Scholarships and grants}}{\text{Gross tuition and fees}}$	Amount of tuition revenue funded by unrestricted institutions resources as well as external resources.
<b>Fundraising Expense to Contribution Ratio</b>	$\frac{\text{Fundraising expense}}{\text{Contribution revenue}}$	Percentage of fundraising costs compared to contribution revenues. Institutions should remember that fundraising costs incurred in one period may result in contributions that will be received in future periods, so consider a three year average. Recommended that not-for-profit organizations spend no more than 35% of related contributions on fundraising.

Source: NACUBO<sup>85</sup>

<sup>84</sup> Ibid., pp. 18-23.

<sup>85</sup> Table adapted nearly verbatim from: Ibid., pp. 25-30.

Jane Wellman, the Executive Director of the Delta Project on College Costs, notes that board members and higher education institution presidents believe that “proper board oversight of spending can help serve as a more robust basis for planning and strategic thinking about options and directions.”<sup>86</sup> However, CFOs note that most cost data collected in account data rather than decision-making data relevant to policy issues.<sup>87</sup>

KPIs are an important way for institutions to present information in a format that is engaging and also relates to trends in institutional performance over time and future goals.<sup>88</sup> However, currently less than one-third of private institutions and just over one-third of public four-year institutions report basic performance-related measures to their boards. Most institutions present aggregated expenditures rather than performance-related metrics like costs per student or per degree or other benchmarking data.<sup>89</sup>

Taking into consideration the results of a large-scale survey of CFOs in higher education institutions on the role of board involvement in cost management and cost control, as well as advice from the board members themselves, Wellman provides a number of suggestions for improving cost management in higher education, including:<sup>90</sup>

- Identify and measure cost drivers.
- Develop benchmark data using a close set of peers.
- Educate board on “business model”—student/faculty ratio, full-time/adjunct faculty, cost per discipline, tuition discounting, cost per recruitment.
- Link year-to-year budgets with factors and goals of the strategic plan. Make sure all strategic plan objectives have action plans that detail costs;
- Find ways to look out five years — look at relation of price, discounting, revenue, quality, and market.

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<sup>86</sup> Wellman, Op cit., p. 1.

<sup>87</sup> Ibid., p. 5.

<sup>88</sup> Ibid., pp. 7-8.

<sup>89</sup> Ibid., p. 2.

<sup>90</sup> Bulleted points selected from list and reproduced verbatim from: Ibid, p. 7.

# APPENDIX

**Figure A.1: Selected Sample Footnote Disclosures Recommended by NACUBO’s Blank Slate Project**

**CASH AND INVESTMENTS (Combined in one note and including the information about liquidity)**

Disclosures should cover:

- > Cash allocation philosophy/strategy
- > Deposit and custodial risks
- > Asset allocation mix
- > Maturity schedule of investments for the asset allocation categories by levels 1, 2, and 3
- > Liquidity

Possible presentation:

**Step 1 (formulaically)**

Cash and receivables	\$ XX,XXX
+ Level 1 investments (considered liquid)	XXX,XXX
+ Level 2 and 3 investments maturing in less than 2 years	XXX,XXX
<b>Gross liquid assets</b>	<b>XXX,XXX</b>

**Step 2 (formulaically)**

All remaining investments	YYY,YYY
- Perpetual designations	(YY,YYY)
<b>Residual investments</b>	<b>YYY,YYY</b>

**Step 3 (evaluation)**

1. If residual investments are greater than zero then gross liquid assets equal the entity’s liquidity base
2. If residual investments are less than zero, then the negative residual amount is added to gross liquid assets to produce the entity’s liquid base

**Step 4 (formulaically)**

Liquidity base (from Step 3 evaluation)	XXX,YYY
- Purpose designations over the next 12 months	(ZZ,ZZZ)
<b>Net liquidity</b>	<b>\$ XXX,ZZZ</b>

**Step 5 (evaluation—if net liquidity is less than zero)**

(a) Nonliquid investments needed to cover negative net liquidity (level 2 and 3 investments maturing > 2 years)	aaa
(b) Estimated cost to liquidate (a)	bbb
Possible outflow of investment resources*	aaa + bbb

\* MD&A discussion of the impact of an outflow of investment resources to the organization (include comparison to average net income margin, spending targets and rates, time to recover, etc.)

**ENDOWMENT**

	Quasi-endowments Funds functioning as endowment	True endowments	
		Perpetual portion	Earnings and appreciated portion
Balance at beginning of year	\$ Y,YYY,YYY	\$ Y,YYY,YYY	\$ Y,YYY,YYY
Additions	YYY,YYY	YYY,YYY	
Distributions	(YYY,YYY)		(YYY,YYY)
Investment returns	Y,YYY,YYY		(YYY,YYY)
Balance at end of year	<b>\$ Y,YYY,YYY</b>	<b>\$ Y,YYY,YYY</b>	<b>\$ (YYY,YYY)</b>

The true endowment balance at the end of FYX1 and FYX0 includes \$Y,YYY,YYY and \$X,XXX,XXX, respectively, that is required, by donor stipulation, to be retained in perpetuity.

At the end of FYX1 and FYX0, a YY and XX funds totaling \$YY,YYY and \$XX,XXX, respectively, had fair values below the amount required to be retained in perpetuity. These amounts are reflected as a reduction in "Endowment gains (losses) for use in future periods" in the Statement of Changes in Resources.

>> A general discussion of the endowment including laws governing it, how payout is determined, and so forth, should be included.

>> If desired, a reconciliation to the amount reported for the NACUBO-Commonfund Study could be included.

<b>STUDENT INCOME</b>	
Gross tuition	\$ XXX,XXX
Tuition discount	
University scholarships from designated funds	(X,XXX)
Undesignated scholarships	(X,XXX)
<b>Net tuition revenue</b>	<b>\$ AAA,AAA</b>
Funding sources	
Student payments	
Students and parents	\$ Y,YYY
Institutional loans to students	Y,YYY
Pell Grants	Y,YYY
VA	Y,YYY
Other third-party payments for students	Y,YYY
Total student payments	YY,YYY
Government grants (federal, state, local)	YY,YYY
Government loans	YY,YYY
Third-party payments	Y,YYY
Institutional loans	YYY
Uncollected	YY
<b>Net tuition revenue</b>	<b>\$ AAA,AAA</b>

Source: Craig and Menditto<sup>91</sup>

<sup>91</sup> Craig and Menditto, Op. cit.

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