Georgia 2013 Conference for College & University Auditors
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Agenda

- Introductions
- GASB Statement No. 60
- IRS Colleges and Universities Compliance Project
- Accounting for PPVs’
- Fraud
- Topics Colleges and Universities should be aware of related to Foundations
- Questions
GASB Statement No. 60
Accounting and Financial Reporting for Service Concession Arrangements
Issued November 2010

Effective for periods beginning after December 15, 2011
Service Concession Arrangements

- Statement addresses service concession arrangements (SCAs)
- SCAs are a *type* of public-private or public-public partnership
- The term public-private partnership is used to refer to a variety of:
  - Service arrangements (outsourcing a service)
  - Management arrangements (outsourcing mgmt)
  - SCAs (last type before being a privatization)
Service Concession Arrangements

- [Link](http://www.gasb.org/cs/BlobServer?blobkey=id&blobwhere=1175822186062&blobheader=application%2Fpdf&blobcol=urldata&blobtable=MungoBlobs)
Accounting and Financial Reporting
For Service Concession Arrangements

What is a service concession arrangement?

• Public-private or public-public partnership
• An arrangement between a transferor (a government) and an operator (governmental or nongovernmental) in which:
  1) the transferor conveys to an operator the right and related obligation to provide public services through the operation of a capital asset in exchange for significant consideration, such as an up-front payment, installment payments, a new facility (constructed by the operator), or improvements to an existing facility
  2) the operator collects and is compensated by fees from third parties
Benefits of SCAs

- May provide government with the ability to leverage existing infrastructure and other public assets to generate additional resources in the form of up-front payments from the operator for the right to operate such assets.
- May be used to facilitate construction and financing of new infrastructure and other public assets and transfer the risks associated with their construction and maintenance to a private entity.
- May be used to provide services to the general populace in a more efficient and cost-effective manner.
Service Concession Arrangements

**Transferor Accounting:**

- If facility associated with the SCA is an existing facility—transferor should continue to report the facility as a capital asset.
- If facility associated with the SCA is a new facility, purchased or constructed by the operator, or an existing facility that has been improved by the operator—transferor should report:
  - The new facility or the improvement as a capital asset at **fair value** when it is placed in operation,
  - Any contractual obligations as liabilities, and
  - A corresponding deferred inflow of resources equal to the difference between the fair value of the asset and the liabilities.
- There is no booking of construction in progress—cost/benefit concerns.
Service Concession Arrangements

Transferor Accounting (continued):

- A transferor should recognize a liability for certain obligations to sacrifice financial resources under the terms of the arrangement. Liabilities associated with the SCA should be recorded at their PRESENT VALUE if the obligation is significant and meets either of the following criteria:
  - Contractual obligations that directly relate to the facility (for example, obligations for capital improvements, insurance, or maintenance on the facility)
  - Contractual obligations that relate to a commitment made by the transferor to maintain a minimum or specific level of service in connection with the operation of the facility (for example, providing a specific level of police and emergency services for the facility or a minimum level of maintenance to areas surrounding the facility)
Service Concession Arrangements

Transferor Accounting (continued):

◦ After initial measurement, the capital asset is subject to existing requirements for depreciation, impairment, and disclosures
  • The capital asset should not be depreciated if the arrangement requires the operator to return the facility to the transferor in its original or an enhanced condition
  • The corresponding deferred inflow of resources should be reduced and revenue should be recognized in a systematic and rational manner over the term of the arrangement
  • If a liability is recorded to reflect a contractual obligation, the liability should be reduced as the transferor’s obligations are satisfied. When the obligation is satisfied, a deferred inflow should be reported and the related revenue should be recognized in a systematic and rational manner over the term of the arrangement
◦ Improvements made to the facility by the operator during the term of the SCA should be capitalized as they are made and are subject to the requirements for depreciation, impairment, and disclosures
Service Concession Arrangements

Transferor Accounting (continued):

- If an SCA requires up-front or installment payments from the operator, the transferor should report:
  - The up-front payment or present value of installment payments as an asset
  - Any contractual obligations as liabilities, and
  - A deferred inflow of resources equal to the difference between the two

- Revenue should be recognized as the deferred inflow of resources is reduced. This revenue should be recognized in a systematic and rational manner over the term of the arrangement
Service Concession Arrangements

Governmental Operator Accounting:

- The governmental operator would report an intangible asset for the right to access the facility and collect third-party fees from its operation at cost (for example, the amount of an up-front payment or the cost of construction of or improvements to the facility)
  - Amortized over the term of the arrangement in a systematic and rational manner
- Improvements made to the facility during the arrangement would increase the governmental operator’s intangible asset if the improvements increase the capacity or efficiency of the facility
Service Concession Arrangements

**Governmental Operator Accounting:**
- If the arrangement requires a facility to be returned in a specified condition and information is prominent that indicates the facility is not in the specific condition, and the cost to restore the facility to that condition is reasonably estimable, then a liability, and generally and expense to restore the facility should be reported.
IRS Colleges and Universities Compliance Project
IRS Colleges and Universities Compliance Project

- Exempt Organizations officials released the final report (posted April 25, 2013, Executive Summary revised May 2, 2013) on its tax-exempt colleges and universities compliance project.
- The multi-year project, begun in 2008, included a questionnaire sent to 400 colleges and universities and subsequent audits of 34 selected academic institutions. The final report focuses on the results of these examinations, especially in the areas of unrelated business income and executive compensation.
IRS Colleges and Universities Compliance Project

PPV ACCOUNTING

• What we are seeing vs. proper accounting
PPV ACCOUNTING (taken from year end auditor training with Ben Riden)

- Institution’s Accounting Implications
  - Institution should record as Capital Asset and Lease Purchase obligation when project is complete. From an accounting perspective, completion is deemed to be when “Certificate of Occupancy” is received.
  - The Capital Asset and the related lease purchase obligation (liability) are recorded at the lesser of:
    1) Fair market value of the asset at the inception of the lease, or
    2) Present Value of the minimum lease payments.  

    We have historically used sources/uses of funds from the bond documents to make these calculations. However, in recent conversations with representatives of CPA firms conducting some of our foundation audits, it has been suggested that we use the actual project costs, which is essentially the same as the present value of the minimum lease payments, to record as our Capital asset value and lease liability. This will not change our total rent payments over the life of the lease, but it will change the distribution between principal and interest and will be more in line with how foundations are reporting the lease receivable.

    The ancillary costs included in the sources and uses will no longer be considered part of our project costs. However, for projects already on the books, we are not suggesting any changes to capitalized balances or debt schedules because we don’t believe there would be any significant effect on the financial statements since there would be no change to overall net asset balances.

  - The basic rental payments, along with the lessee’s incremental borrowing rate are used to create lease purchase debt/liability schedules for the institutions. A portion of the rental payment is considered principal reduction with the remainder of the payment recognized as interest expense.
  - In many situations, the first year’s bond payments are covered by funds held in the Capitalized interest account at the Foundation’s trustee. This was done to allow schools to build cash reserves from fees during the first year of the project. In those cases the institution’s actual cash payments are reduced, but the interest expense should be recorded for the full amount and the principal of the debt will be increased because interest is effectively being financed in the transaction.
  - Facility projects are designed and fees are assessed with the intention of generating 5% coverage ratio (cash reserve) for each project. Any cash reserves generated should stay with the project and are not intended to be used to facilitate costs of other projects.
  - The additional rental payments paid to the Foundation for R&R purposes are considered maintenance expense for the institutions and do not affect the Capital Asset or lease purchase calculations.
PPV ACCOUNTING

Institution’s Accounting Implications:

- GHEFA projects are subject to funding limitations authorized by legislature.
- Accounting and reporting is basically the same for GHEFA projects as with normal PPV projects.
- On some GHEFA projects, institutions forward fund some initial project costs that will eventually be captured by the Foundation and that will be reimbursed. Institutions would normally reflect these costs as prepaid items.
  - For GHEFA projects, just as with GSFIC projects, if the institution has only received a letter of intent from GSFIC to sell bonds, but the bonds have not been sold, the institution cannot record a prepaid. This creates accounting issues for the institutions, because in that scenario, the school has to record the initial project costs as their own.
  - GHEFA managers have also provided a mechanism whereby institutions may place on deposit with the Foundation, institutional funds that will be used on the project. These funds are supposed to be used only for “removable capital items” (equipment). Institutions should record the expenditure of these funds as Construction in Progress until the Certificate of Occupancy is received on the project, then the costs should be moved to permanent capital assets.
  - **Note:** State law specifically prohibits capital improvements to leased assets, so no institutional funds should be used to make permanent capital improvements to an asset where the State/Institution does not hold title.
PPV ACCOUNTING

Foundation’s Accounting Implications:

- Foundation carries original bond debt (debt to bond holders) until debt is serviced.
- Foundation should record the asset as an Investment in Capital lease.
  - Foundation should not carry the property as a Capital Asset after “Certificate of Occupancy” has been provided to institution.
  - Foundation’s Investment in Capital Lease should mirror what the Institution is carrying as Lease Purchase liability (debt). Therefore, as the Institution’s lease liability reduces each year, the Foundation’s Investment in the Capital Lease should also reduce.
- As mentioned on the previous slide, institutions may place funds on deposit with the Foundation. The Foundation owns the bank accounts where the funds are held, therefore, the Foundation should record these funds in a “fiduciary/trust” capacity.
### PPV ACCOUNTING

- **Foundation Entries**
  - Record Bond Transaction

<table>
<thead>
<tr>
<th>Account Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restricted Cash Project Fund</td>
<td>18,138,249.88</td>
</tr>
<tr>
<td>Revenue Bonds Payable</td>
<td>21,845,000.00</td>
</tr>
<tr>
<td>Bond Discount</td>
<td>576,924.55</td>
</tr>
<tr>
<td>Restricted Cash - Capitalized Interest Project Fund</td>
<td>1,922,571.81</td>
</tr>
<tr>
<td>Bond Issuance Cost</td>
<td>364,658.17</td>
</tr>
<tr>
<td>Restricted Cash - Debt Service Reserve Project Fund</td>
<td>842,595.59</td>
</tr>
<tr>
<td></td>
<td>21,845,000.00</td>
</tr>
<tr>
<td></td>
<td>21,845,000.00</td>
</tr>
</tbody>
</table>
• **Foundation Entries**
  ◦ **Recording Construction of Asset**

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction in Progress (Project Cost Fund)</td>
<td>18,138,250.00</td>
</tr>
<tr>
<td>Cash</td>
<td>18,000,000.00</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>138,250.00</td>
</tr>
</tbody>
</table>

Construction is Progress has been increased by an accounts payable set up for any residual funds remaining in the restricted cash project fund account. In most all cases when the Certificate of Occupancy is provided there are still some residual funds remaining that will be spent on the project. These amounts should be captured and capitalized as part of total project costs and this entry will recognize that activity and capture to project costs in Construction in Progress. As these funds are actually paid out the A/P will be liquidated.
**PPV ACCOUNTING**

- **Foundation Entries**
  - Record Lease Receivable
    - Unearned income of 39,391,250, which is interest portion of the lease payments, has been netted against capital lease receivable in this entry.

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Lease Receivable (net)</td>
<td>18,138,250</td>
</tr>
<tr>
<td>Construction in Progress</td>
<td>18,138,250</td>
</tr>
</tbody>
</table>

- **Institution Entries**
  - Record Asset and Capital lease
  - **Capitals ledger entry**

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Asset-Building</td>
<td>18,138,250</td>
</tr>
<tr>
<td>Capital Lease Obligation</td>
<td>18,138,250</td>
</tr>
</tbody>
</table>
PPV ACCOUNTING

- Institution Entries
  - Actuals ledger
  - Base rent payment

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal Expense</td>
<td>818.100</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>818.200</td>
</tr>
<tr>
<td></td>
<td>5,000.00</td>
</tr>
<tr>
<td></td>
<td>100,000.00</td>
</tr>
<tr>
<td>Cash</td>
<td>105,000.00</td>
</tr>
</tbody>
</table>
PPV ACCOUNTING

- **Institution Entries**
  - **Actuals Ledger**
  - **Annual Rent, Repair and Replacement Payment**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maintenance Expense</td>
<td>55,000.00</td>
</tr>
<tr>
<td>Cash</td>
<td>55,000.00</td>
</tr>
</tbody>
</table>
PPV ACCOUNTING

- Institution Entries
  - Capitals Ledger
  - Offset to Principal portion of base rent payment

<table>
<thead>
<tr>
<th>Capital lease obligation</th>
<th>5,000.00</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal Expense</td>
<td>5,000.00</td>
</tr>
</tbody>
</table>

- This is year-end entry 18a
PPV ACCOUNTING

• Institution Entries
  ◦ Capitals Ledger
    • Record Depreciation Expense

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation Expense</td>
<td>600,000.00</td>
</tr>
<tr>
<td>Accumulated Depr.</td>
<td>600,000.00</td>
</tr>
</tbody>
</table>
Fraud in Colleges and Universities
Statistics on Fraud

- Statistics on Fraud
  - The 2012 ACFE (Association of Certified Fraud Examiners) survey estimated, on average, organizations lose 5% of revenues to fraud annually
  - The median loss was $140,000 with 20% of incidents in excess of $1,000,000 (all types of entities)
  - Most fraudsters are first time offenders with clean employment history
Statistics on Fraud

• Statistics on Fraud
  • The majority of fraud is discovered by a tip from an employee or by chance
  • The primary reasons:
    • Lack of internal controls
    • Ability to override existing controls
    • Lack of management review
Types of Fraud

- Types of fraud
  - Internal
  - External
  - Organizational
- Can be subdivided into
  - Asset misappropriation
  - Fraudulent financial reporting
Fraud – Incentives and Pressures

• Reasons for the particular vulnerability of colleges and universities:
  ◦ Moderate salary levels
  ◦ Reluctance of most universities to prosecute from fear that fundraising will be hurt by negative publicity
  ◦ Lack of segregation of duties due to ongoing budget cuts
Procurement Fraud

- http://www.osc.state.ny.us/audits/allaudits/093012/10s45.pdf
Topics Colleges and Universities Should Be Aware of Related to Foundations
Foundations

• **501(c)(3) Not-For-Profit Organizations**
• **Form 990**
• **Philanthropic**
  ◦ Foster and manage gifts
  ◦ Promote the cause of higher education
  ◦ Receive and manage financial donations
  ◦ Provide: support for the teaching, research, public service and outreach programs
• **Real Estate**
  ◦ Manage certain real estate acquisitions, development and construction projects
Foundations

- PPV Lease
- Office of Advancement/Development Controls
- Compensation – Salaries Paid by the College/University
- Same Staff at Foundation as College/University
Questions?