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Development of College and University Accounting and Reporting

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By William B. Franke

In the early days of the history of institutions of higher education when students were few, funds were comparatively insignificant and physical plant consisted of only a few buildings or perhaps of only one, it was a relatively simple matter to record the financial transactions of such institutions. In many instances single-entry bookkeeping systems were used and the books, which consisted of cash-receipts-and-disbursements journals and of student records, were kept by a clerk or by one of the professors.

However, as the wealth and population of the country increased, as professional services came to be of greater importance and in greater demand, and as the value of a college education and of organized research became more apparent, student enrolments vastly increased. This necessitated enlarged physical plants and far greater amounts of money, not only for physical plant extensions, but also for instruction, research and general operating expenses. Such additional sums of money were obtained through student fees, federal and state appropriations and gifts for plant, endowment, scholarships, loans to students, maintenance and special research projects.

The increases in income and resources of colleges and universities brought new problems relating to the accounting of the financial transactions of such institutions. The bookkeeping system which had been adequate in earlier days became quite inadequate. The many ramifications of a large modern institution, such as the present-day state university, required the recording and accumulating of transactions far beyond the capacity of the old bookkeeping system.

Strangely, however, the improvement in bookkeeping methods for institutions of higher education did not keep pace with the increase in the size and resources of such institutions. As a result, in many colleges and universities today, the bookkeeping systems in force are entirely inadequate for the proper recording of the financial transactions.

Some institutions have developed their resources to such a point that they are comparable in wealth of assets to large commercial enterprises. It is inconceivable that any corporation, small or large, could achieve success and permanency of existence without an accounting system which would provide its management with informative statements of financial position and operating results. I know of one important educational institution, however, which was established about 1800 but had never had a balance-sheet prepared for or by it until June 30, 1931. It had prepared annual statements of income and expense which were really statements of receipts and disbursements. They included gifts for endowment, money received from bank loans, the repayment of loans and other items unrelated to operating income and expense. This institution is not by any means unique; there were and perhaps are many others in an equally unenviable position.

During the past few years there has been considerable agitation for the development of a proper accounting system for colleges and universities. The increase in the country's wealth and prosperity gave many men time for affairs other than their own businesses. Successful business men began to interest themselves in civic affairs, in charitable institutions and in educational institutions. Boards of trustees of colleges and universities gradually included in their memberships more and more business men of large interests, both for the valuable advice which such men might give and because of the possibility of obtaining gifts from them. These men had been accustomed to receive correct and informative statements of financial position and operating results in their own businesses, and they demanded such statements for the colleges and universities in which they had become interested. Further agitation was created by federal and state departments and private foundations, principally in order that figures might be available for many institutions from which valuable comparisons might be made. In the case of at least one foundation I understand that a gift to an institution is not made unless that institution has an adequate accounting system and an acceptable method of reporting.

The accountancy profession seems to have provided modern accounting systems for almost every type of activity except educational institutions. For some reason this field has been neglected by practising accountants.

The first real work on the subject of college and university accounting was published by the Carnegie Foundation in 1910, the second by Trevor Arnett for the General Education Board in

1922, and the third by Lloyd Morey, comptroller of the University of Illinois, in 1930.

Generally speaking the purpose of these publications was twofold. The first, and perhaps the more important, was the development of financial reports which would set forth the financial position and the operating results of institutions of higher education. The second was the devising of a system of accounting to produce, with a minimum of effort, the figures to be included in such reports.

It must be understood that a commercial accounting system is not satisfactory for a college or university. The principal objection to the commercial accounting system for this type of institution is that it does not adapt itself to academic needs. On the contrary it has the effect of attempting to mold academic and research policies into the standard scheme of commercial accountancy. In many instances systems have been installed in educational institutions by accountants who are thoroughly conversant with the requirements of systems for commercial enterprises, but have no knowledge whatsoever of the operation and administration of an educational institution, of the problems of such an institution or of the information which a proper accounting system in such an institution should disclose. Perhaps the principal difficulty has been that the accountant has failed to recognize the fact that the institution is a trustee of funds and not a corporation formed for the purpose of producing profits.

It is not the purpose of this article to discuss in full the principles of institutional accounting, but a few illustrations will indicate how institutional accounting differs from commercial accounting.

A college receives gifts for endowment. The income from such gifts is expendable either for general or restricted purposes, but the principle must be maintained intact. It is obvious that such gifts can not be merged into an ordinary surplus account. On the contrary, they must be segregated from surplus in order that the institution, in its capacity as trustee, may separately account for them as long as the institution is in existence. Furthermore, the assets represented by these gifts must also be recorded separately in order to show that the gifts have been invested in income-producing securities and not used to finance current operations, as would be the case if gifts were invested, for example, in inventories or accounts receivable. To set forth the fact that gifts for endowment have been properly conserved, a separate section for endowment should be included in the balance-sheet. This section should show on the right hand side the total gifts for endowment and on the left hand side the investments of these gifts, classified as to nature. The total investments, of course, should equal the total gifts.

If income from a particular endowment is restricted for special purposes and if all such income is not expended during the year, the unexpended portion must be withheld from current income and carried forward to the succeeding year. This requires rather elaborate records in which are set forth the income from each restricted endowment fund and the expenditures chargeable against such income. The income account for the year should include as income from restricted endowment funds only an amount equivalent to the expenditure of such income.

It is often said that depreciation on educational plant need not be considered. Mr. Arnett says that "since present and past generations have provided existing buildings, it is neither unwise nor unfair to expect future generations to do as well." If a fund-accounting system is used and separate self-balancing sections are maintained for plant, current and other funds, as subsequently described, the accrual of depreciation by journal entry does not serve any useful purpose. Depreciation funds, if created, should be represented by cash or securities resulting from transfers from current income to plant funds. Such transfers should be charged to current expense. I do not believe however that any institution is in a position today to set aside depreciation funds of this nature on its entire educational plant even at a very low annual rate.

In a commercial enterprise capital additions are charged to plant accounts, not against current expense, and are depreciated over a period of years. In an educational institution depreciation on educational plant is not usually recorded. Therefore, fixed assets, such as furniture and equipment, which are purchased out of current income, are charged to current expense. One reason for this is that since only a certain amount of income is available the nature of the expenditure of such income is unimportant. If purchases of furniture and equipment from such income were directly capitalized instead of being charged to expense the result would be that the income shown as available actually would not be available. It would be possible, of course, to transfer from current cash and current income to plant-funds cash and plant funds amounts equivalent to capital expenditures to be made. Then such capital expenditures could be made from plant-funds cash and capitalized directly. Actually this is what is done in the case of gifts for buildings. The cash is deposited in a plant-fund bank account and credited to plant funds; the expenditures are made from plant-funds cash and capitalized. In the case of expenditures for furniture and equipment, such as departmental furniture and laboratory equipment, which are financed from current income, it is preferable to charge to current expense. Since a certain amount of expenditures of this nature must be made annually comparative expenditure statements are more trustworthy and informative if these expenditures are charged to operations. However, these expenditures should be capitalized at the end of each year by a journal entry charging plant assets and crediting plant funds. Disposals are eliminated from plant assets by a reverse entry.

These illustrations will indicate some of the differences between accounting for educational institutions and accounting for commercial enterprises.

As a result of the agitation for uniform reports for institutions of higher education, and at the request of the United States office of education, the national committee on standard reports for institutions of higher education was formed in 1930. This committee is composed of representatives of the Association of University and College Business Officers of the Eastern States, of the Southern Educational Buyers and Business Officers Association, of the Western Association of University and College Business Officers, of the Association of American Colleges and the Council of Church Boards of Education, of business officers of Pacific Coast universities and colleges, and of the American Association of Collegiate Registrars. Its work is financed by the General Education Board.

The first bulletin of the committee was published in September, 1930, and was entitled *A Study of Financial Reports of Universities and Colleges in the United States*. That report clearly indicated the absence of any reasonable uniformity in the published reports of institutions of higher education.

Colleges and universities may be broadly classified into two principal groups, public and private. It was formerly the opinion that because of the differences in the methods of financing such institutions a uniform method of reporting, applicable to each type, could not be devised. However, in recent years these institutions have grown more alike. In many instances private institutions have been designated as the recipients of public appropriations and in many instances public institutions have received funds from private gifts. The committee reached the conclusion that reasonable uniformity in the reports of the two classes of institutions was possible and highly desirable.

In July, 1931, the committee published a bulletin entitled *Suggested Forms for Financial Reports of Colleges and Universities.* These forms are designed for both public and private institutions. The committee has not published a bulletin describing the accounting system and procedure necessary to produce the results recommended in its bulletin on standard reports, but it is a fact that an institution adopting the suggested form of report must plan its accounting system so that the desired results may be achieved with the least effort.

The committee considers that the following statements are essential to present a general financial picture of a college or university:

Balance-sheet
Statement of current funds
Statement of income of current funds
Statement of expenditures of current funds
Statement of restricted expendable funds
Statement of endowment and other non-expendable funds
Statement of loan funds
Statement of plant funds

Supporting schedules to these statements may be presented as desired.

The balance-sheet recommended by the committee is sectionalized into the following groups, each of which is self-balancing: current funds (sub-divided into general and restricted) loan funds, endowment and other non-expendable funds, plant funds and agency funds.

The term "fund," as used by the committee, represents the present principal of a sum received, which is for the purpose of producing income, or the present balance of a sum received or earned, which is expendable for general purposes or for a specified purpose. Accounts representing present balances of funds appear, therefore, on the liability side of the balance-sheet and represent the difference between the assets and liabilities.

Under general current funds are included assets available for general expenditure, liabilities to be liquidated from such assets and current surplus and reserves.

Under restricted current funds are included assets available for restricted expenditure, such as unexpended income from restricted endowment and expendable gifts for restricted purposes, liabilities and restricted funds.

The loan-funds section shows the amount available for loans, notes receivable and a balancing figure representing total loan funds.

The endowment section shows total gifts for endowment offset by assets in the form of cash, securities or institutional property, in which endowment funds have been invested, thus showing whether or not gifts for endowment have been maintained intact, Endowment funds are subdivided into:

(a) Funds which are to be maintained permanently inviolate for the purpose of producing income;
(b) Funds not specifically designated for endowment, which have been assigned to endowment and are functioning in that manner at the time of the report;
(c) Funds on which annuities to designated beneficiaries are being paid during an agreed time. If these funds are separately invested, they may be placed in a separate balance-sheet group.

The committee recommends that endowment funds be further classified as follows:

(a) Funds the income of which is available for general purposes;
(b) Funds the income of which is designated for any restricted purpose other than for student aid;
(c) Funds the income of which is designated for student aid.

The committee recommends that annuity funds should be classified as:

(a) Funds designated for endowment;
(b) Funds designated for plant;
(c) Funds unrestricted as to use.

It will be observed that several different classes of funds are included in the endowment section. The identity of the individual funds, however, must be maintained in subsidiary ledger accounts. One reason for including the various classes of funds in this section is because their assets are often pooled for investment purposes.

Under plant funds are shown cash and securities available for additional investment in plant, plant assets, plant liabilities and the amount already invested in plant representing plant funds which have been so used. Under agency funds are shown the amount of such funds and the investments of such funds.

The other schedules recommended by the committee set forth the changes in the fund balances during the year and the current income and expense of the institution.

Current income is divided into three sections, (1) educational and general income, which includes income from student fees, endowment income, public appropriations and tax levies, gifts and grants from private sources, sales and services of educational departments and miscellaneous, (2) income from auxiliary enterprises and activities, such as residence and dining halls, student hospital, bookshop, athletics and student union, and (3) income to be used for other non-educational purposes, such as fellowships and scholarships, and income from investments subject to annuity provisions.

Current expense is sub-divided into the same three sections as income. Under educational and general expense are included general administration and expense, resident instruction and departmental research, organized research, extension, libraries and operation and maintenance of physical plant. The classifications of expense under auxiliary enterprises and activities and other non-educational purposes correspond to the classifications of current income for these groups.

The provision of separate sections for income and expense of auxiliary enterprises is logical. These enterprises are of a business character, operated for the service of the student body or the faculty, and intended, for the most part, to be self-supporting. They are not directly related to the educational work of the institution.

Although the committee report on uniformity in reporting was not published until July some institutions have already adopted the form recommended. The committee recognizes that this report is not perfect and that, after trial, improvements may be necessary. However, it has given great impetus to the movement for standardized reports for institutions of higher education. While the report may be subject to change in certain respects it has taken into consideration the peculiarities of accounting for institutions of higher education and provides a clear and comprehensive method of setting forth the financial position and operations of such institutions. If a large number of the more important of the colleges and universities of this country will adopt the form of report advocated by the committee—and this seems likely—not only will a basis of uniform comparison be provided but each institution will be directly benefited by having available informative figures essential for the help and guidance of its administration.