Journal of Accountancy

Volume 41 | Issue 1 Article 4

1-1926

Lack of Uniformity in College and University Accounting

William B. Franke

Lack of Uniformity in College and University Accounting

By William B. Franke

It is generally understood that the colleges and universities of this country have not, in the past, maintained proper accounting systems. As these institutions have grown, the necessity for adequate systems has become more and more apparent, but unfortunately in many instances the systems finally installed have been taken over bodily from private business enterprises without being revised to give effect to the peculiar accounting requirements of educational institutions. Furthermore, to quote Professor J. P. Adams of Brown university, "Professional accountants and others interested in the problems of accounting as such have been busily engaged in building a body of doctrine and procedure for private business to the partial exclusion of a general consideration of the accounting requirements of the various quasi-public institutions."

It has, therefore, devolved upon the man in charge of the business administration of the college or university either to install his own accounting system or to adjust the private business system thrust upon him by his board of trustees to the particular requirements of his institution. The result has been the installation of all kinds of systems and the adoption of various methods of recording the same accounting facts.

Providentially, in 1922 there was published by the general education board a book written by Trevor Arnett, entitled *College and University Finance*. This book states the principles underlying college accounting and describes a complete system of accounting. The system is an admirable one and has been adopted in whole or in part by a large number of educational institutions.

Mr. Arnett's book has been of incalculable value from the standpoint of uniformity. Other aids to uniformity have been the formation of associations of university and college business officers, which have held annual meetings at which have been discussed various business and accounting problems, and conferences of representative college and university financial officers held under the auspices of the general education board at

Chicago in 1923 and 1924. As a result of these activities there gradually have been evolved certain principles covering the recording of accounting transactions and the presentation of accounting results. However, because of the peculiar characteristics of the accounting problems of educational institutions and the lack of proved theories, no one person can declare that these principles are correct and that all others are incorrect. Naturally there are still many differences of opinion and the situation at the present time is that many officers of business administration feel that their own methods are proper and they are therefore unwilling to adopt any other methods.

Readers of this article who are unfamiliar with the accounting peculiarities of educational institutions may question why there should be any doubt as to the proper method of recording and presenting accounting facts and results in view of the well established principles of general accounting. It is because the accounting theories applicable to business enterprises can not be applied to educational institutions without modification. Some of the reasons for this are:

(1) A business enterprise is operated for profit. An educational institution is interested only in keeping its expenses within its income. Many institutions, in fact, regularly incur an operating deficit, trusting that it will be offset by contributions for that purpose from alumni and others interested in the institution. It appears to be poor policy to operate upon such a basis, but nevertheless this condition exists, and it must therefore be recognized. At any rate there is no necessity for a college to do more than meet its expenses, for if it builds up a large surplus each year it is charging more than is necessary for tuition and thus may be preventing some young men and women from securing an education.

(2) A business enterprise is responsible to its stockholders. An educational institution is responsible to no one, although it has a moral and legal obligation to individual donors and to the courts for the proper administration of trust funds.

(3) A business enterprise, being operated for profit and being responsible to its stockholders, must in its accounting provide for the accrual of income, the recording of depre-

> ciation of its plant assets, etc. It also must make its accounting conform with the requirements of the federal government because of the income-tax laws. An educational institution has none of these things to consider. Most colleges operate on a cash basis and do not record accruals. The setting up of depreciation on educational plant is not necessary since the institution is operated not with the idea that it will replace its plant when it becomes unfit for use, but that when the time arrives replacement will be made by gifts from its alumni and friends.

In the belief that business officers of educational institutions have arrived at a period of inertia so far as the more universal adoption of uniform methods is concerned, and in the hope that they might be moved to take steps to overcome this inertia if they were made to realize the situation, six questions relating to the recording of accounting facts were picked at random and letters sent containing these questions to ninety-five institutions in the eastern states. Of these ninety-five institutions, two have refused to reply, and one has not been established long enough to adopt definite principles. Of the ninety-two remaining, fifty-seven have answered the questions asked. The results are astonishing and clearly show the lack of uniformity. There follows a discussion of the questions and the replies.

QUESTION NO. 1

Question

(a) Is it your practice to depreciate rental property and property of such service activities as dormitories, dining-halls, and bookstores?

(b) If so, do you fund this depreciation by setting aside in cash the annual amount written off, such cash to be used only for replacing and renewing these properties?

Reply

(a) Fifteen institutions have indicated that they do depreciate rental and service property, and forty-two that they do not. Of those which do take depreciation, one restricts it to all equipment, four to bookstore fixtures, one to dining-hall equipment, and two to dormitories. One of the institutions which sets aside depreciation on dormitories does so by crediting to the reserve-for-depreciation account the net excess of income over expense. What would be done by this institution if it incurred a loss from dormitory operations was not stated. Of those institutions which do not record depreciation, two do not carry plant assets of any sort on their general books of account.

(b) Of the fifteen institutions which depreciate rental and service property, only four fund this depreciation. By this is meant that these four colleges set aside in separate interest-bearing bank accounts, or invest in securities, the annual amounts recorded for depreciation. Interest on the bank balances and securities presumably is added to the depreciation fund. One of these four institutions sets aside an annual amount of approximately 2½ per cent of its total estimated income. This amount is assumed to cover depreciation not only of dormitories and service properties, but of its educational plant as well. It is the only institution, so far as I know, which attempts to set aside a fund to cover depreciation of all of its physical property.

Opinion

(a) The chief function of an institution of learning is the education of its students. It is understood that were a college dependent solely upon tuition fees for its support, these fees would be so high that only the rich could afford an education. By means of endowment and taxation, the annual income of an institution is increased, tuition fees are reduced, and more persons are enabled to secure an education. The funds necessary to establish an institution arise through gifts or grants. Assuming that when the physical plant of the institution becomes unfit for use there will be other givers to replace this plant, there is no necessity to include in the charge to the student any amount to cover such replacement. In other words, there is no necessity for depreciating plant assets used for educational purposes. When, however, an institution establishes and operates rental and service properties, it is entering into activities which are entirely apart from its main purpose. Such activities are usually instituted either because there are no suitable, privately owned establishments of like nature in the locality, or because by conducting them itself the institution may become more self-contained and may thus bring its students into closer communion. For these good and sufficient reasons, the institution therefore operates business enterprises which otherwise would be conducted by outsiders. Since they are business enterprises they should be run as such, and this means, among other things, that depreciation should be taken upon both the buildings occupied by these activities and the equipment used by them.

(b) Assuming that the majority of institutions operates on a cash-receipts-and-disbursements basis, it is obvious that if depreciation is recorded simply by making an entry charging expense and crediting reserve for depreciation, no useful purpose is served since the sole effect is the reduction in the book value of buildings and equipment for record purposes. The proper method is to take from receipts an amount of cash equivalent to the annual depreciation and set this amount aside in a separate bank account or invest it in securities. The entry in the operating section is a debit to expense and a credit to current-fund cash and the entry in the plant section is a debit to depreciation-fund cash and a credit to reserve for depreciation. The income from the investment of this depreciation fund should be reinvested and should increase the fund itself.

QUESTION NO. 2

Question

(a) Your annual budget undoubtedly provides for additions to equipment and as these additions are made the cost thereof is presumably charged to operating expense. At the close of each year do you make an entry in your plant section adding the value of such additions to your plant assets thus keeping these assets at their correct cost value?

(b) Do you eliminate from the plant section the cost value of assets disposed of during the year?

Reply

(a) Two institutions did not specifically answer this question, and two others do not carry plant assets on their general books. Of the remaining fifty-three, thirty-five answered in the affirmative and eighteen in the negative. However, of those which indicated that it is their custom to capitalize additions to plant, ten limit such charges to items of new construction, meaning that they do not capitalize additions to furniture and equipment. Of the eighteen which do not capitalize additions at cost, one inventories its fixed assets annually and records the value shown by these inventories, and one inventories these assets every five years and increases or decreases its book accounts to accord with the amount thus determined.

(b) Under (a) it was stated that ten institutions signified that they limit their capitalization of plant assets to items of new construction. Of the twenty-five which stated that they capitalize all additions, six indicated that it is not their custom to eliminate disposals. There is a certain degree of inconsistency in this method, for surely if additions are capitalized disposals must be eliminated.

Opinion

(a) All additions to plant assets, whether they be for land, buildings or equipment, should be capitalized each year at cost. Land and buildings are usually purchased from funds given for this purpose. New equipment, however, unless it is for a whole new building or department, is usually paid for out of operating income, and since educational institutions operate on a cash basis the cost of such equipment is treated as an operating expense and is written off against operating income. In order that the value of such equipment may be added to plant assets an entry should be made at the close of each year charging the proper equipment accounts and crediting plant funds.

(b) During the year a record should be made of all assets disposed of in any manner and at the end of the year an entry should be made in the plant section debiting plant funds and crediting the respective fixed asset accounts. This has the effect of keeping the plant assets at their correct cost values. For insurance purposes it may be desirable to take periodical inventories, but the values shown by these inventories should not be recorded on the general books of account.

QUESTION NO. 3

Question

(a) Do you add to plant assets the value of library books purchased during the year?

(b) If so, how is the value determined?

Reply

(a) Two institutions did not answer this question. Of the remaining fifty-five, thirty capitalize library books and twenty-five do not.

(b) The methods used in capitalizing library books are interesting. The values are determined as follows: Twenty use cost, six use $1.00 per volume, one uses $3.00 for each book and 50c for each pamphlet, one inventories its library every few years, one inventories its library every five years, and one determines the value to be added each year "in a general way."

Opinion

(a) Library books should be valued each year and such value should be added to plant assets.

(b) As to the method of determining the value, apparently one man's opinion is as good as another's. It is difficult to determine the value to be placed upon library books for the reason that some books become very valuable in a short time while others become worthless almost immediately. It is evident that if library books are valued at cost the fixed assets are inflated, since it certainly would be impossible to sell all these books at the prices which were paid for them. A sponsor of the cost method might say: "If you are going to place an estimated value on the library books you capitalize, why not do the same thing in the case of other fixed assets?" The answer is that the value of library books is subject to so much greater fluctuation than the value of other fixed assets that we must use a different method of estimating their worth. Therefore, it is necessary to be conservative in capitalizing these books, and for this reason the rating of $1.00 per volume used by the American Library Association is favored.

QUESTION NO. 4

Question

(a) Do you record gifts of securities for endowment at market value at the date of gift?

(b) If not, what method do you use?

Reply

(a) One institution did not answer this question and three could not because they have no endowment. Of the remaining fifty-three, thirty-eight record such gifts at market value and fifteen do not.

(b) Of the fifteen which do not use market value, nine use par value, one uses par value for bonds and market value for stocks, one usually uses par value, and four use the value designated by the donor.

Opinion

(a) and (b) The recorded value should be the market value at the date of gift. Of course in many instances market value and par value will be approximately equal, and in these cases the question is unimportant. When market value exceeds par value the donor may ask that he be given credit at the market value and in such a case there is no legitimate reason to object to the use of this value, provided the securities given can be readily disposed of and there is nothing in the terms of the gift to prevent disposing of them at any time. The difficulty arises when market value is less than par value, as in such cases the donor may insist upon his being given credit for his gift at par value. It is a dangerous policy to record such gifts at a greater value than market because if the security is sold before it reaches par a loss is incurred and endowment is reduced. Therefore, the conservative plan is to record gifts at market value at the date of gift. Occasionally cases arise where it is almost impossible to determine the market value. In such instances the value to be used can only be determined by securing the best opinion available as to the present worth of the securities given.

QUESTION NO. 5

Question

(a) Do you treat profit on sale of endowment securities as income or as an addition to endowment?

Reply

(a) Five institutions did not answer this question. Of the remaining fifty-two, forty-eight treat profit on sale as an addition to endowment and four as operating income. In the case of one of the four institutions which treat endowment as income, the reply by the business manager was that such treatment is "as per the board of directors." Apparently the business manager himself does not agree that this is the proper method.

Opinion

(a) Profit on the sale of endowment securities should increase endowment. It may be credited direct to the endowment-fund account or it may be credited to a reserve account to which should be charged any losses on sale of endowment securities. Any profit realized should be reinvested with the other endowment cash. In the report for the fiscal year 1925, of one of the institutions which treats profit on sale of endowment securities as income, there appears a charge against operating income of $7,000 representing the net loss on sale of endowment securities during the year. Had profit on sale of securities in prior years been set aside in a separate account there probably would have been a sufficient balance in this account to absorb the $7,000 loss. Instead of having this amount available, the profits resulting from sales during prior years were spent, with the result that the loss incurred during the past year had to be made up out of operating income. This is a dangerous condition, for it is impossible to foretell the amount of loss that may be incurred on securities owned. Some institutions, as a matter of fact, in addition to setting aside profits on sale of endowment securities also take a certain amount from operating income each year, investing this amount in securities and crediting it to endowment reserve. This practice is continued until the amount of the reserve account is equivalent to about one per cent of the total endowment.

QUESTION NO. 6

Question

(a) Do you carry student notes on your books as an asset or are they simply recorded in a memorandum record?

Reply

(a) A summary of the replies to this question follows:

Six do not accept student notes.

Twenty-eight record student notes in a memorandum record and do not include the value among the assets.

One records student notes in a memorandum record except for a few which are carried as assets.

Four treat them as an asset but reserve the full amount at the close of each year.

One treats them as an asset only when endorsed or accompanied by collateral.

One carries them as an asset at 40 per cent of their face value.

One carries them as an asset at 80 per cent of their face value.

Fifteen carry them as assets at full face value.

Opinion

(a) Since practically all educational institutions operate on a cash-receipts-and-disbursements basis, student notes should not be recorded as assets. If notes are accepted they should be entered in a memorandum record and payments made thereon should be recorded as income in the year in which such payments are received.

From the answers to the foregoing questions it is clear that there is great need for the adoption of certain uniform principles. In sending out this questionnaire six questions were asked—there might have been many more and had a larger number been sent out, the replies to each question would undoubtedly have indicated just as great a diversity of method. How uniformity can be secured is a problem. Any plan which attempts to impose an unyielding accounting system upon all educational institutions must be avoided. As Mr. Arnett has said aptly, "Our idea of uniformity in college accounting is that there should be uniform agreement regarding the underlying principles and that, in so far as possible, things of the same kind in the several institutions should be similarly classified and described. We feel that there are scarcely two institutions at which all the circumstances and conditions are identical. There must be room in the system, therefore, to provide for these variations and to describe the peculiar conditions which prevail at every institution."

The writer has suggested to the secretary of the Association of University and College Business Officers of the eastern states that a committee be appointed to study this question of uniformity seriously. By means of meetings, and possibly questionnaires, this committee could, during the course of a year, determine the majority opinion on certain accounting questions. These questions could then be submitted to an annual meeting of the association and voted upon, with the idea that the principles adopted should be made effective in all the institutions belonging to the association. This would go a long way toward securing "uniformity of underlying principles" and would be a tremendous step toward more effective accounting for educational institutions.