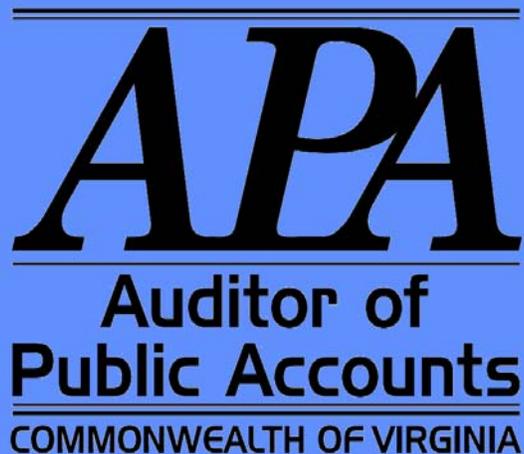


**AUXILIARY ENTERPRISES
ACCOUNTING AND REPORTING ISSUES
AT VIRGINIA'S STATE-SUPPORTED UNIVERSITIES**

SEPTEMBER 14, 2007



AUDIT SUMMARY

The total price of college attendance is typically a combination of tuition and mandatory fees; however, for numerous reasons, trying to compare what services each part of the total price covers is difficult. At some universities, the tuition component includes a charge for services that other universities charge as part of their mandatory fees. Additionally, some universities consider those same services as part of their general operations while others consider these services as separate business activities commonly called auxiliary enterprises.

Since tuition and mandatory fees are the components of the total price of attendance, the differences decrease the transparency necessary for state decision-makers to evaluate tuition and fee increases. In reviewing the accounting principles used by Virginia's state-supported universities in accounting and reporting on their auxiliary enterprises, we found additional inconsistencies in auxiliary enterprise accounting.

Due to the passage of time, changes in the auxiliary enterprises business environment, and changes in accounting principles, the Schedule of Auxiliary Enterprises Revenues and Expenses prepared by each university may not meet the needs of university and state decision makers. Further, the lack of consistency between the various universities' schedules precludes their use for central monitoring or statewide comparisons. In addition, the current format of the Schedule of Auxiliary Enterprise Revenues and Expenses does not consistently report information on fund balances and reserves.

We make the following recommendations to improve accounting and reporting for auxiliary enterprises at Virginia's state-supported universities.

1. We recommend that SCHEV, in consultation with financial management of Virginia's state-supported universities, develop a principle-based definition of those activities funded from mandatory fees.
2. We recommend that SCHEV, in consultation with financial management of Virginia's state-supported universities, update and refine its auxiliary enterprise accounting guidance. The guidance should include principles for identifying activities as auxiliary enterprises, accounting procedures, and the process for allocating debt service and indirect costs to individual auxiliary enterprises.
3. We recommend the universities monitor auxiliary enterprises to determine whether they are self-supporting and document and approve transfers between auxiliary enterprises.
4. If SCHEV continues to require Virginia's state-supported universities to prepare the Schedule of Auxiliary Enterprises, then SCHEV, in consultation with the financial management of Virginia's state-supported universities and the Auditor of Public Accounts, should develop specific, consistent procedures for preparing the schedule.
5. As in Recommendation 4, if SCHEV determines that the Schedule of Auxiliary Enterprises is necessary, then SCHEV, in consultation with the Auditor of Public Accounts and the financial management of Virginia's state-supported universities, should develop specific, consistent procedures for preparing a Schedule that shows the sources and uses of Auxiliary Enterprises reserves.

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Auxiliary Enterprise Accounting and Reporting Issues

Introduction

The total price of college attendance is typically a combination of tuition and mandatory fees; however, for numerous reasons, trying to compare what services each part of the total price covers is difficult. At some universities, the tuition component includes a charge for services that other universities charge for as part of their mandatory fees. Additionally, some universities consider certain services as part of their general operations while others consider those same services as separate business activities, commonly called auxiliary enterprises.

In addition to the inconsistency of the method of addressing service cost as either tuition or mandatory fee, there exists inconsistencies in the method of accounting and monitoring of auxiliary activities. Guidance that the universities use to classify and account for their auxiliary enterprises is outdated and has resulted in the universities accounting for similar activities differently in their financial statements. These differences as well as other changes in accounting standards have led the universities to make different changes in how they prepare their annual financial report on their auxiliary enterprises.

This report will attempt to address the following issues. What are the accounting differences between universities in accounting for auxiliary enterprises, and is there a method to provide consistency? Second, how should the universities define auxiliary enterprises and revise their accounting and reporting models to achieve consistency? Finally, how can universities change their annual reporting to better indicate if these businesses are self-supporting and reflect the full cost of their operations?

Background

The price of education at Virginia's state-supported universities is comprised of three components that make up the cost of attendance: tuition, mandatory fees, and room, board and other services.

- *Tuition* supports instruction and related educational activities included in the university's programs including instruction, research and public service, and academic and institutional support. Tuition also includes Educational and General (E&G) fees.
- *Mandatory fees* are student charges to support non-instructional activities such as health services, intercollegiate athletics, recreational activities, and bus services. Each university charges students a comprehensive fee to cover all or most of these services that are generally available to all students.
- *Room, board and other service activities* are optional fees to support services such as the dormitory and dining functions for students choosing to live on-campus. These services charge a fee, which vary by the type of housing or dining plan or services used. All of Virginia's universities dedicate these revenues to supporting these activities. The distinct factor for these services is that the student incurs these costs only if they elect to use the service.

Each university has its own process for determining how it will fund the different activities, and there is little consistency among the institutions as to how similar activities are charged to the student. We found that activities such as recreational sports and telecommunications, which are common between the universities, are funded through tuition at some universities, other universities fund those same activities through mandatory fees, and still other universities separately sell telecommunication and internet services.

The Appropriation Act limits the universities to an increase in mandatory fees of no more than 5 percent annually. Universities may increase these fees at a higher rate if the increased revenues support any of the following.

- State-mandated wage, salary, and fringe benefit increases
- Capital projects authorized by the General Assembly
- Student health services
- Other fee increases specifically authorized by the General Assembly

In addition, each institution reports their final fees and the general reasons for their fee increases to the State Council of Higher Education for Virginia (SCHEV) each year for monitoring purposes.

Mandatory Fees Support Different Activities at Each University

There is little comparability between the institutions with regard to the proportions representing tuition and mandatory fees as components of the universities' total price of attendance during the 2007-2008 academic year. Although the total price of attendance varies between Virginia's state-supported universities, half are within a \$500 range above or below \$6,600. This would lead to the conclusion that most universities offer the same general student services. However, when we compared the proportion of mandatory fees related to the total price of attendance between Virginia's state-supported universities, we found that mandatory fees ranged from 17 percent to 49 percent of total price.

While tuition rates may vary across universities due to the variety of programs offered, the reasons for the lack of comparability of mandatory fees across the universities is less apparent. Because of differences in how each university has developed its financial structure and added services over its history, the proportion of the total price allocated to tuition as opposed to mandatory fees ranged from 83 percent to 51 percent among the universities.

Tuition as a Percentage of Total Mandatory Cost of Attendance
For the 2007-08 Academic Year

	Tuition	Tuition as a Percentage of Total Cost	Mandatory Fees	Fees as a Percentage of Total Cost	Total Mandatory Cost of Attendance
VT	\$6,160	83%	\$1,237	17%	\$7,397
UVA	6,821	80%	1,679	20%	8,500
GMU	5,035	74%	1,805	26%	6,840
VCU	4,525	73%	1,671	27%	6,196
UMW	4,530	70%	1,964	30%	6,494
RU	4,026	65%	2,150	35%	6,176
VMI**	5,062	63%	2,981	37%	8,043
ODU	4,042	62%	2,486	38%	6,528
CWM	5,637	62%	3,527	38%	9,164
CNU	4,046	57%	3,004	43%	7,050
VSU	3,186	56%	2,469	44%	5,655
LU	4,338	54%	3,720	46%	8,058
NSU	2,700	51%	2,622	49%	5,322
JMU	3,420	51%	3,246	49%	6,666

The chart excludes Room and Board, as it is not a “mandatory” cost of attendance.

* Data reflects in-state undergraduate students, as obtained from the 2007-2008 SCHEV Tuition and Fees Report.

** Fees do not include Unique Military Activity Fees (quartermaster fees) of \$2,005.

The above differences between tuition and mandatory fees, when combined with differences in accounting and reporting mandatory fees, makes it difficult to compare tuition and fees among universities. Since tuition and mandatory fees are the components of the total price of attendance, the differences decrease the transparency necessary for state decision-makers to evaluate tuition and fee increases. Comparability between universities is further complicated by the fact that different institutions view and charge for the same service in different ways.

After this comparison of total mandatory fees at each university, we decided to compare the individual components of mandatory fees as reported by the State Council of Higher Education for Virginia in its annual Tuition and Fee Report. This comparison revealed significant differences based on factors such as external revenue generated by athletics programs or differences between student health programs at residential universities compared to those with a higher proportion of commuter students. However, we also noted that activities such as recreational sports or telecommunications might be a distinct portion of the comprehensive fee at some universities, included in a general student activity fee at other universities, and supported by tuition at still other universities. For example, as noted in the table that follows, 13 of the 14 state supported universities reported student health as a separate auxiliary enterprise and one state supported university included the charge for student health services in the comprehensive fee.

Activity	Reported as Separate Auxiliary Enterprise	Not Reported as Separate Auxiliary Enterprise
Student Health	13 Universities	UMW
Telecommunications	LU and CWM	12 Universities
Parking and Transportation	12 Universities	VMI and UMW
Recreational Facilities	UVA, LU, CNU, RU and NSU	9 Universities

Chart 2

Components of Comprehensive Mandatory Fees
For the 2007-08 Academic Year

	VT	UVA	GMU	VCU	UMW	RU	VMI*	ODU	CWM	CNU	VSU	LU	NSU	JMU
Athletics	232	607	453	379	567	735	1177	921	1153	1056	748	1702	1233	1058
Student Health	290	370	93	176	-	207	182	120	411	191	221	126	74	179
Parking and Transportation	95	135	45	201	-	51	-	60	58	-	26	80	48	68
Student Activities and Organizations	297	47	186	90	443	110	1622	530	254	82	332	180	264	575
Student Services and Student Union	145	216	-	718	-	239	-	216	-	675	42	124	-	-
Recreational Sports	178	-	-	-	-	-	-	-	-	-	-	162	-	-
Auxiliary Services	-	-	156	-	-	-	-	-	366	-	-	770	-	-
Debt Service	-	164	220	-	700	-	-	269	575	703	259	230	597	-
Facilities and Buildings	-	-	538	10	254	341	-	370	414	44	340	81	122	795
Recreational Facilities	-	140	-	-	-	233	-	-	-	253	-	25	21	-
Campus Improvement	-	-	-	-	-	-	-	-	-	-	190	-	-	-
Auxiliary Central and Indirect Costs	-	-	114	-	-	234	-	-	-	-	-	-	23	571
Residential Services	-	-	-	18	-	-	-	-	-	-	-	-	-	-
Contingency Fund	-	-	-	79	-	-	-	-	-	-	-	-	68	-
Security, Police and Public Safety	-	-	-	-	-	-	-	-	-	-	272	-	172	-
Personal Computer Maintenance	-	-	-	-	-	-	-	-	29	-	-	-	-	-
Telecommunications	-	-	-	-	-	-	-	-	267	-	-	240	-	-
Radio Station	-	-	-	-	-	-	-	-	-	-	39	-	-	-
Total Comprehensive Fee	1237	1679	1805	1671	1964	2150	2981	2486	3527	3004	2469	3720	2622	3246

Source: 2007-08 SCHEV Tuition and Fee Report

* Fees do not include Unique Military Activity Fees and quartermaster fees of \$2,005.

Considerable disparities in the number and type of activities supported by mandatory fees exist among the universities because of differences in service levels, external financial support, or established infrastructure. In addition, the categories of activities listed in the SCHEV fee report are not comparable across the universities. Furthermore, the inconsistency of the amounts charged for mandatory activities creates confusion for state decision makers, students, and parents when trying to compare tuition and fees across Virginia's state-supported universities.

Improved comparability of mandatory fees between the universities would allow the Boards of Visitors to better evaluate tuition and fee increases at their own university and the impact increases will have on affordability and access. Additionally, SCHEV and other state decision makers would be able to provide valuable oversight in assessing the need for increases in mandatory fees and possible ways to mitigate those increases.

Recommendation 1 - We recommend that SCHEV, in consultation with financial management of Virginia's state-supported universities, develop a principle-based definition of those activities funded from mandatory fees. This definition should include a model of those activities that universities should fund through tuition and those activities to be funded by mandatory fees or other charges. The definition should also require the universities to use similar names and definitions for common activities.

Universities Use Inconsistent Principles in Auxiliary Enterprise Accounting

In reviewing the accounting principles used by Virginia's state-supported universities in accounting and reporting on their auxiliary enterprises, we found inconsistencies in auxiliary enterprise accounting. In addition to those services supported by mandatory fees, auxiliary enterprises include activities operated by the universities to support students beyond their academic programs. These auxiliary enterprises include food services, dormitories, bookstores, and other business operations run by the university for students, faculty, and staff. These activities are not part of the total price of attendance, but represent a fee for services such as a room or board fee or direct sale price in a bookstore.

Recently, universities have also been including as auxiliary enterprises other self-supporting activities that do not provide goods or services to students. In the past, most universities reported these activities either as an operating department or as an internal service activity. The most recent guidance for Virginia's state-supported universities is the Chart of Accounts issued by SCHEV in 1990. This Chart of Accounts includes a definition of those activities that should be accounted for by universities as auxiliary enterprises.

An Auxiliary Enterprise is an entity which exists to furnish goods or services to students, faculty, or staff. This classification is based upon the nature of the service being provided and the client served and not the "self-supporting" aspect of the activity. The charged fee should be directly related, although not necessarily equal, to the cost of the service.

SCHEV Chart of Accounts for Virginia State-Supported Colleges and Universities, July 1, 1990

Since the development of the SCHEV Chart of Accounts and auxiliary enterprise definition, the National Association of College and University Business Officers (NACUBO) has refined the general guidance defining auxiliary enterprises to include other self-supporting activities. These activities are enterprises that universities operate as self-supporting businesses despite the fact that they generally do not provide direct services to students. These other self-supporting activities should generate their own revenue through charges to university departments and other users and not require a share of mandatory fees to maintain their operations.

The NACUBO guidance allows the universities to group activities with similar business type financial goals together instead of grouping these internal service activities with the university's educational and general operations. Based on our review of auxiliary enterprises, Virginia's state-supported universities are inconsistently classifying these self-supporting activities as either auxiliary enterprises or operational divisions.

Also since the development of the SCHEV Chart of Accounts, most universities have outsourced one or more of their auxiliary enterprises including bookstores, food services, and dormitory operations. The universities account for the revenues from these outsourced activities differently which leads to additional variations between the universities in their accounting and reporting of outsourced auxiliary enterprises.

Additionally, some universities establish auxiliary enterprises because they are using revenue-supported debt to fund building projects. Since the university must certify the project will generate sufficient revenue to make debt service payments, the university creates an auxiliary enterprise that exists only for the purpose of collecting rent equal to the debt service payments.

The lack of detail in these definitions has allowed the universities to broadly interpret what is an auxiliary enterprise. Chart 2 of this report details the types of auxiliaries found at each university, and it shows that some auxiliaries exist at only a few universities or a single university.

As stated earlier, several universities have set up separate auxiliary enterprises to charge a fee to fund debt service for bonds used to construct buildings for auxiliary enterprises, and other universities have set up separate auxiliary enterprises to fund building maintenance, indirect costs, or general auxiliary enterprise expenses that have no direct benefit to any one activity. These separate auxiliary enterprises are not in agreement with the SCHEV Chart of Accounts or general accounting principles that would require the accumulation of all costs for an auxiliary enterprise occur in one activity.

By using these general auxiliary enterprises, which have no specific activity, some universities are using a portion of the comprehensive fee to cover an auxiliary enterprise's indirect costs or other expenses. Therefore, students receiving goods or services also pay the equivalent of an auxiliary enterprise overhead charge.

Where one university's auxiliary enterprise charges and expenses do not include indirect and facility costs, those charges and expenses will appear considerably less than another university's charges and expenses that distribute indirect and facility costs. This exclusion of indirect and facility costs represents another inconsistency in auxiliary enterprise accounting that continues to detract from comparability.

Recommendation 2 - We recommend that SCHEV, in consultation with financial management of Virginia's state-supported universities, update and refine its auxiliary enterprise accounting guidance. The guidance should include principles for identifying activities as auxiliary enterprises, accounting procedures, and the process for allocating debt service and indirect costs to individual auxiliary enterprises. The guidance should also address consistent accounting for outsourced auxiliary enterprises services. Additionally, SCHEV should advise the universities on how to apply the NACUBO guidance related to other self-supporting activities and reporting those activities in the Commonwealth Accounting and Reporting System and auxiliary enterprise reports.

Current Auxiliary Enterprises Are Not Always Self-Supporting

The SCHEV 1990 Chart of Accounts states that each university should ensure that its "auxiliary system meets the test of 'self-supporting,' including direct and indirect costs." Additionally, "Institutions are encouraged to operate each category of auxiliaries on a self-supporting basis." There has been a lack of consistency in the application of the Chart of Accounts' guidance by Virginia's state-supported universities.

Auxiliary enterprises can generally be divided into two categories: those that are supported solely by charges for goods or services such as bookstores and food services and those that are supported by the comprehensive fee. While certain auxiliary enterprises, such as intercollegiate athletics, generate significant revenues from outside the comprehensive fee, they still depend on the comprehensive fee to fully support their expenses. Those auxiliary enterprises that are solely supported by charges for services should set their charges to fully fund their expenses, including indirect costs, and maintain reserves. Auxiliary enterprises that share the comprehensive fees collected from students should support their expenses through their allocation of the comprehensive fee.

Universities may need to change those allocations during the fiscal year to react to changes in costs for specific auxiliary enterprises or changes in enrollment. However, any other types of changes to the allocation mask the auxiliary enterprise's lack of self-sufficiency and the need to reconsider fee levels and future budgets.

Several institutions have interpreted the guidance that auxiliary enterprises be self-supporting to mean that the total of all auxiliary enterprises should achieve the self-supporting test. There are universities that have auxiliaries that show no revenue for an entire year, and often revenue from one auxiliary enterprise activity covers the deficits of other auxiliary enterprises. Other universities strive to maintain a positive operating balance for each auxiliary, without the use of transfers from other activities.

Universities should demonstrate to their Boards of Visitors that they have recommended fee rates and established expense budgets that would allow self-supporting auxiliary enterprises. Auxiliary enterprises should generate charges for services that, along with comprehensive fees, directly support the activities of the auxiliary enterprise. At the end of the fiscal year, university management should prepare a report for the Board of Visitors that outlines the yearly results of operations for auxiliary enterprises and specific plans to resolve any deficits.

Additionally, universities should create a policy covering transfers between auxiliary enterprises and university management should report to the Board of Visitors the nature and cause of significant transfers to or among auxiliary enterprises. Generally, the auxiliary enterprise generating the collections should retain the revenues, rather than regularly transferring the amount to another activity to provide either all or most of that auxiliary enterprise's revenue.

Recommendation 3 - Best practices in managing auxiliary enterprises include monitoring auxiliary enterprises to determine whether they are self-supporting and documenting and approving transfers between auxiliary enterprises. We recommend the universities follow these best practices in order to implement the changes that revised accounting guidance would require.

Current Schedule of Auxiliary Enterprises is Not a Useful Tool for Decision Makers

Due to the passage of time, changes in the auxiliary enterprises business environment, and changes in accounting principles, the Schedule of Auxiliary Enterprises Revenues and Expenses may not meet the needs of university and state decision makers. The schedule included in each university's annual audit report reflects business operations as they existed over twenty years ago. Further, the lack of consistency between the various universities' schedules precludes their use for central monitoring or statewide comparisons.

SCHEV had requested, as part of the Auditor of Public Accounts' annual audits of the state-supported universities' financial statements, that the Auditor's report include a summary schedule of auxiliary enterprises revenues and expenditures. In the late 1970's, at the request of the General Assembly and SCHEV, the Auditor of Public Accounts conducted a review of auxiliary enterprises accounting, reporting, and financial management at the state-supported universities.

After this review, the Auditor of Public Accounts worked with SCHEV to develop a Schedule of Auxiliary Enterprises Revenues and Expenses for inclusion in each university's audit report. Over time, each university's schedule began to have slight differences from the other universities' schedules. For example, some schedules would display a cumulative fund balance for each auxiliary enterprise where others may show a fund balance in total or just display current year activity. Additionally, with the implementation of Governmental Accounting Standards Board Statements 34 and 35 in 2002, some universities moved to the full accrual basis of accounting used for the university's overall financial statements.

University management, Boards of Visitors, and other stakeholders should be able to monitor the performance of individual auxiliary enterprises and the university's auxiliary enterprise activity as a whole using the Schedule. Additionally, statewide decision-makers should be able to compare auxiliary enterprises across universities by comparing similar schedules. It is time to revise and standardize the basis for the Schedule of Auxiliary Enterprises.

There needs to be well-defined procedures for Virginia's state-supported universities to use in preparing their annual Schedule of Auxiliary Enterprises. The universities should use the modified accrual basis of accounting for auxiliary enterprise operations that emphasizes cash flows plus reserves (modified accrual) as opposed to full accrual accounting. The auxiliary schedule should also display all transfers between auxiliary enterprises, transfers to reserves, and transfers for debt

payments. Using a business model, the schedule should also demonstrate that all remaining funds at the end of the fiscal year are transferred to either operating or capital reserves.

Recommendation 4 - If SCHEV continues to require Virginia's state-supported universities to prepare the Schedule of Auxiliary Enterprises, then in consultation with financial management of Virginia's state-supported universities and the Auditor of Public Accounts, SCHEV should develop specific, consistent procedures for preparing the schedule. An example of a proposed schedule is in Appendix I following the report.

Current Auxiliary Enterprise Schedule Does Not Provide Information on Reserves

The current format of the Schedule of Auxiliary Enterprises Revenues and Expenses does not consistently report information on fund balances and reserves. Some universities report a continuing fund balance that includes reserves for each auxiliary on the schedule. Others report amounts set aside for reserves as being transferred out of the annual activity and not included as an ending auxiliary enterprise fund balance.

Since the reserves often support capital projects not reported on the current auxiliary schedule, many universities do not include the accumulation and uses of these reserve balances on the current schedule. The universities also report an annual auxiliary enterprise reserve plan to SCHEV that details their operating, renewal and replacement, and capital reserves for their auxiliary enterprises in total for the upcoming year, which many times does not relate to the Schedule's financial information.

The 1990 Chart of Accounts states that there are three categories of auxiliary enterprise reserves related to different expenditures or budgets:

- *Operating Reserves:* The operating reserve should include amounts designated for working capital and for contingencies.
- *Reserves for Renewal and Replacement:* The reserve for renewal and replacement should include amounts set aside for expenditures needed to repair, improve, renovate, or replace long-lived assets.
- *Reserves for Major Renovation, Acquisition, and Plant or Program Expansion:* The program expansion reserve should include funds accumulated to provide for the major renovation, construction, or purchase of new facilities or equipment.

Reporting the balances and activities of significant individual auxiliary enterprise reserves in the university's annual audit report would provide meaningful information for the university's stakeholders as to the financial position of the auxiliary enterprises and the accumulation and use of reserve funds. Boards of Visitors and statewide decision makers could then monitor the university's progress towards reserve balance goals and ensure that appropriate long-term planning is taking place. Enterprises that do not accumulate sufficient reserves could then be budgeted to accumulate the necessary reserves, while those enterprises with excess reserves could use those reserves to improve service or decrease rates. Reporting the balances and activities of these reserves would also

allow decision makers to ensure that amounts set aside as one auxiliary enterprise's reserve are not used to make up another enterprise's deficit.

Recommendation 5 – As in Recommendation 4, if SCHEV determines that the Schedule of Auxiliary Enterprises is necessary, then SCHEV in consultation with the Auditor of Public Accounts and the financial management of Virginia's state-supported universities, should develop specific, consistent procedures for preparing a Schedule, which shows the sources and uses of Auxiliary Enterprises Reserves. Appendix II following this report has an example of the proposed schedule.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

**Auditor of Public Accounts
P.O. Box 1295
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September 14, 2007

The Honorable Timothy M. Kaine
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Thomas K. Norment, Jr.
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have completed our review of **Auxiliary Enterprises Accounting and Reporting Issues at Virginia's State-Supported Universities** and submit our report. We conducted our review in accordance with the standards for performance audits set forth in Government Auditing Standards, issued by the Comptroller General of the United States.

Objectives

Our objectives for our review of auxiliary enterprises accounting and reporting issues at Virginia's state supported universities were:

1. To review the definition and classification of auxiliary enterprises to establish the comparability of auxiliary enterprises and related fees between universities.
2. To review the oversight and standardization of auxiliary enterprise accounting and reporting.
3. To review the effectiveness of the current Schedule of Auxiliary Enterprises and develop any required improvements.
4. To review guidelines for maintenance of operating and capital reserves and related oversight and reporting.

Scope

Our study included a review of auxiliary enterprise accounting and reporting at all of Virginia's senior state-supported universities. As branch campuses of other Universities that are not separately audited by our Office, the University of Virginia's College at Wise and Richard Bland College were not included in our review. Virginia's Community Colleges generally do not operate significant auxiliary enterprises and similarly were not included in our review.

Methodology

Our review procedures included a comparison of Virginia's state-supported Universities' charges for tuition and mandatory auxiliary enterprises. We reviewed guidance provided to universities related to auxiliary enterprise accounting and reporting from national standards and from the State Council for Higher Education in Virginia. We also reviewed the Schedules of Auxiliary Enterprises in the audit reports for the state-supported universities over the past three years and compared those schedules. We reviewed the basis of accounting and other reporting issues used by the universities in managing their auxiliary enterprises and in preparing the Schedules. We reviewed budgeting, reserve, and accounting procedures at a sample of Universities. We discussed auxiliary enterprise accounting and reporting issues with financial management of the University of Virginia, Virginia Tech, Radford University, and Christopher Newport University. We also discussed these issues with staff of the State Council for Higher Education in Virginia.

Conclusions

Since our last review of auxiliary enterprises in the 1970s, accounting and reporting for auxiliary enterprises at Virginia's state-supported universities has become less consistent between universities. This has made comparisons between the universities as to those services that are funded through tuition as compared to services funded by mandatory fees, as to budgeting and reporting of auxiliary enterprises, as to use of the Schedule of Auxiliary Enterprises to measure performance, and as to determining the adequacy of capital and operating reserves difficult or impossible.

We make the following recommendations to improve accounting and reporting for auxiliary enterprises at Virginia's state-supported universities.

1. We recommend that SCHEV, in consultation with financial management of Virginia's state-supported universities, develop a principle-based definition of those activities funded from mandatory fees.
2. We recommend that SCHEV, in consultation with financial management of Virginia's state-supported universities, update and refine its auxiliary enterprise accounting guidance. The guidance should include principles for identifying activities as auxiliary enterprises, accounting procedures, and the process for allocating debt service and indirect costs to individual auxiliary enterprises.
3. We recommend the universities monitor auxiliary enterprises to determine whether they are self-supporting and document and approve transfers between auxiliary enterprises.
4. If SCHEV continues to require Virginia's state-supported universities to prepare the Schedule of Auxiliary Enterprises, then in consultation with financial management of Virginia's state-supported universities and the Auditor of Public Accounts, SCHEV should develop specific, consistent procedures for preparing the schedule.
5. As in Recommendation 4, if SCHEV determines that the Schedule of Auxiliary Enterprises is necessary, then SCHEV in consultation with the Auditor of Public Accounts and the financial management of Virginia's state-supported universities, should develop specific, consistent procedures for preparing a Schedule, which shows the sources and uses of Auxiliary Enterprises Reserves.

Exit Conference and Report Distribution

We exposed the draft report to the State Council of Higher Education for Virginia and have included their response in this report.

This report is intended for the information and use of the Governor and General Assembly, SCHEV, management at Virginia's state-supported Universities, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

JHS/whb



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September 17, 2007

Mr. Joseph H. Stepp
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Dear Mr. Stepp:

Thank you for the opportunity to comment on your report, "Auxiliary Enterprises Accounting and Reporting Issues at Virginia's State-Supported Universities." I want to commend you on the professionalism exhibited in the report and in the presentation you made on the report at the October 5 SCHEV Finance Advisory Committee meeting. Our staff and the institutional representatives appreciated your willingness to share drafts of the document and we thank you for accepting our input to the process.

- **Changes in Higher Education**

Much of the accounting and reporting guidance discussed in the report dates back three decades or more. There have been many changes in Virginia higher education as well as SCHEV over the last 20-30 years. For instance, in the 1980's the SCHEV Finance and Facilities staff numbered more than 10 individuals. A good portion of their time was devoted to accounting and reporting issues. Today, our Finance Policy section is staffed by three full-time employees (there is also one vacant position currently) devoted primarily to system-wide planning and budget policy issues. The primary accounting and reporting work takes place at our institutions of higher education and, of course, agencies such as the Departments of Accounts, Treasury, Planning and Budget, and the Auditor of Public Accounts.

Certainly one of the most significant changes that we have experienced in Virginia higher education took place between the first and second drafts of your report—namely, the 2005 Restructuring Act. Under this legislation, and the Management Agreements for covered institutions in 2006, the decentralization of various higher education functions that had begun as pilot programs in the 1980's could be broadened if institutions agreed to work toward a set of state goals and meet certain performance standards. In general, SCHEV could not support any

recommendation that might be interpreted as being in opposition to the tenets of restructuring or that might restrict the authority of the institutional Boards of Visitors.

- **Tuition and Fees**

As you know, the Code of Virginia holds each institution's Board of Visitors accountable for the financial management of the institution including the establishment of the institution's tuition and fee rates. The General Provisions of the Appropriation Act require SCHEV to report to the Governor and the House Appropriations and Senate Finance Committees each year on these charges. Our 2007-08 report on tuition and fees is easily found on our website www.schev.edu. It covers some 36 pages and provides the reader with definitions for the various student charges, including those that support educational and general activities as well as auxiliary enterprise activities. Charges are provided by institution and by student level (undergraduate, graduate and first professional). They are shown over time in both actual and inflation-adjusted dollars. They are also compared with similar charges in other states and shown as a percentage of income over time. Finally, each mandatory non-educational and general (auxiliary enterprise) fee is shown by category of activity—as approved by each institution's Board of Visitors. It is our clear understanding that this report, which has been required and produced annually for many years, has been very informative to policymakers as well as students and their parents.

In the section of your report entitled, "Mandatory Fees Support Different Activities at Each University," there seems to be a general assumption that a problem exists because of the disparity and mix between tuition and mandatory fees at the various institutions and the relative percentage of such mandatory fees to tuition and fees. We tend to look at it differently. The diversity of our institutions is often mentioned as one of our system's best traits—a hallmark in fact. The size and scope of a program, along with managerial emphasis issues are the primary reasons for the range of mandatory fees. The variation in the types and level of services provided to students, faculty and staff, through auxiliary operations, is driven in part by the expectations of the higher education community, the availability of those services locally, and the history of each institution.

We would expect to see great differences among the institutions, especially when comparing large universities to smaller colleges. In athletics, for example, some colleges would have to charge a higher athletic fee because of their limited ability to generate ticket and other ancillary, conference, licensing, and philanthropic support. Another example is related to student health, where an institution may offer basic clinic services versus full mental and physical health services. We applaud diversity. Efforts to make institutions all look alike would not be in the best interest of the citizens of the Commonwealth.

- **Recommendations**

Recommendation 1 – We recommend that SCHEV, in consultation with financial management of Virginia’s state-supported universities, develop a principle-based definition of those activities funded from mandatory fees. This definition should include a model of those activities that universities should fund through tuition and those activities to be funded by mandatory fees or other charges. The definition should also require the universities to use similar names and definitions for common activities.

Recommendation 2 – We recommend that SCHEV, in consultation with financial management of Virginia’s state-supported universities, update and refine its auxiliary enterprise accounting guidance. The guidance should include principles for identifying activities as auxiliary enterprises, accounting procedures, and the process for allocating debt service and indirect costs to individual auxiliary enterprises. The guidance should also address consistent accounting for outsourced auxiliary enterprises services. Additionally, SCHEV should advise the universities on how to apply the NACUBO guidance related to other self-supporting activities and reporting those activities in the Commonwealth Accounting and Reporting System and auxiliary enterprise reports.

Recommendation 3 – Best practices in managing auxiliary enterprises include monitoring auxiliary enterprises to determine whether they are self-supporting and documenting and approving transfers between auxiliary enterprises. We recommend the universities follow these best practices in order to implement the changes that revised accounting guidance would require.

In response to Recommendations 1-3, SCHEV agrees that the 1990 “Chart of Accounts for Virginia State-Supported Colleges and Universities” should be updated to reflect the most current industry guidance on auxiliary enterprises as presented by the National Association of College and University Business Officers (NACUBO) and the American Institute of Certified Public Accountants (AICPA), as well as the best practices agreed upon by the financial management of Virginia’s state-supported institutions of higher education and the Auditor of Public Accounts, Commonwealth of Virginia.

There is a wide range of auxiliary activity at our institutions. The proper definition and classification of activities to be included in the auxiliary category within the Commonwealth’s Chart of Accounts is important. The self-supporting nature of auxiliaries must be respected and the auxiliary reserves should be effectively managed. The Chart of Accounts exists to provide guidance for the effective and efficient operation of Virginia’s institutions of higher education. SCHEV will need to rely heavily on the accounting expertise resident at the colleges and universities to accomplish this task. As in the past, updates to the Chart of Accounts will be fully vetted through the Finance Advisory Committee and all relevant parties including the Department of Accounts, the Department of Planning and Budget and the Auditor of Public Accounts.

Mr. Joseph H. Stepp
September 17, 2007
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While the APA recommendations are focused on auxiliary enterprises accounting and reporting issues, the Chart of Accounts covers that and much more. If updates are to be made for auxiliary enterprises, SCHEV staff must determine if these changes should be made alone or as part of an overall update to the now 17 year-old document. Again, the Finance Advisory Committee will be surveyed regarding the extent of the revisions needed.

Recommendation 4 – If SCHEV continues to require Virginia’s state-supported universities to prepare the Schedule of Auxiliary Enterprises, then in consultation with financial management of Virginia’s state-supported universities and the Auditor of Public Accounts, SCHEV should develop specific, consistent procedures for preparing the schedule. An example of a proposed schedule is in Appendix I following the report.

Recommendation 5 – As in Recommendation 4, if SCHEV determines that the Schedule of Auxiliary Enterprises is necessary, then SCHEV, in consultation with the Auditor of Public Accounts and the financial management of Virginia’s state-supported universities, should develop specific, consistent procedures for preparing a Schedule, which shows the sources and uses of Auxiliary Enterprises Reserves. Appendix II following this report has an example of the proposed schedule.

In response to Recommendations 4 and 5, SCHEV staff is of the opinion that the current Schedule of Auxiliary Enterprises is out of date and no longer necessary. We therefore recommend that the Schedule be discontinued in the next reporting period.

Again, thank you for the opportunity to comment on your report on auxiliary enterprises. We are available to discuss the comments with you.

Sincerely,



Daniel J. LaVista

Appendix 1

Model Schedule of Auxiliary Enterprises Revenues and Expenses

	Dining Services	Residential Facilities	Student Health
Revenues:			
Student Tuition and Fees	\$ -	\$ -	\$ 5,965,408
Auxiliary Enterprise Revenue	5,292,174	21,814,047	723,515
Gifts	-	-	-
Investment Income	332,684	66,635	36,025
Total Revenues	5,624,858	21,880,682	6,724,948
Expenses:			
Compensation and Benefits	1,769,630	6,082,041	5,173,655
Supplies and other Services	-	3,680,895	1,388,651
Utilities	654,137	3,860,642	121,580
Other	20,402	39,493	40,403
Total Expenses	2,444,169	13,663,071	6,724,289
Revenues over Expenses	3,180,689	8,217,611	659
Transfers for Debt Service	(298,000)	(1,450,000)	-
Transfers to Capital Outlay Reserves	(2,440,000)	(6,400,000)	-
Transfers to Maintenance Reserves	(250,000)	(1,000,000)	-
Transfers (to)/from Operating Reserves	(192,689)	632,389	(659)
Net Revenue/(Expenses)	\$ -	\$ -	\$ -

Stores & Shops	Student Activities	Parking & Transportation	Athletics	Other Auxiliary	Total
\$ 312,370	\$ 8,935,698	\$ 1,960,361	\$ 6,762,308	\$ 1,233,073	\$ 25,169,218
27,162,652	2,565,205	6,185,741	23,798,178	4,884,437	92,425,949
-	-	-	15,515,407	-	15,515,407
79,459	52,050	18,292	256,773	382,792	1,224,710
27,554,481	11,552,953	8,164,394	46,332,666	6,500,302	134,335,284
3,516,965	4,227,873	3,104,952	15,928,981	1,978,473	41,782,570
19,458,658	1,737,079	-	12,888,601	834,759	39,988,643
160,369	596,497	634,218	1,329,690	701,881	8,059,014
690,751	57,697	98,766	1,053,530	339,186	2,340,228
23,826,743	6,619,146	3,837,936	31,200,802	3,854,299	92,170,455
3,727,738	4,933,807	4,326,458	15,131,864	2,646,003	42,164,829
-	(2,340,000)	(1,280,500)	(6,700,000)	-	(12,068,500)
(205,000)	(500,000)	(1,230,000)	(4,500,000)	(1,500,000)	(16,775,000)
-	(775,000)	(1,550,000)	(3,750,000)	(975,000)	(8,300,000)
(3,522,738)	(1,318,807)	(265,958)	(181,864)	(171,003)	(5,021,329)
\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

Appendix 2

Model Schedule of Auxiliary Enterprises Reserves

	Dining Services	Residential Facilities	Student Health
Beginning reserve balance July 1	\$ 5,007,000	\$ 8,231,000	\$ 127,000
Additions:			
Transfers to capital outlay reserves	2,440,000	6,400,000	-
Transfers to renewal and replacements reserves	250,000	1,000,000	-
Transfers from operations	192,689	-	659
Deductions:			
Capital outlay expansions	-	(400,000)	-
Renewals and replacements	(1,152,000)	(4,924,000)	-
Transfers to operations	-	(632,389)	-
Ending reserve balance June 30	\$ 6,737,689	\$ 9,674,611	\$ 127,659
Dedicated for capital outlay	\$ 4,445,000	\$ 7,750,000	\$ -
Designated for renewals and replacements	985,000	1,645,000	-
Designated for operations	1,307,689	279,611	127,659
Total ending reserve balance June 30	\$ 6,737,689	\$ 9,674,611	\$ 127,659

Stores & Shops	Student Activities	Parking & Transportation	Athletics	Other Auxiliary	Total
\$ 3,199,200	\$ 450,000	\$ 4,230,000	\$ 12,450,000	\$ 9,427,000	\$ 43,121,200
205,000	500,000	1,230,000	4,500,000	1,500,000	16,775,000
-	775,000	1,550,000	3,750,000	975,000	8,300,000
3,522,738	1,318,807	265,958	181,864	171,003	5,653,718
-	(550,000)	-	(13,324,929)	-	(14,274,929)
(505,000)	-	(2,050,000)	-	(1,875,000)	(10,506,000)
-	-	-	-	-	(632,389)
<u>\$ 6,421,938</u>	<u>\$ 2,493,807</u>	<u>\$ 5,225,958</u>	<u>\$ 7,556,935</u>	<u>\$ 10,198,003</u>	<u>\$ 48,436,600</u>
\$ 755,000	\$ 79,000	\$ 3,230,000	\$ 1,250,000	\$ 7,545,000	\$ 25,054,000
350,000	895,000	1,450,000	5,200,000	1,225,000	11,750,000
5,316,938	1,519,807	545,958	1,106,935	1,428,003	11,632,600
<u>\$ 6,421,938</u>	<u>\$ 2,493,807</u>	<u>\$ 5,225,958</u>	<u>\$ 7,556,935</u>	<u>\$ 10,198,003</u>	<u>\$ 48,436,600</u>