Perspectives in Higher Education

2009

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Introduction

In response to a convergence of many fiscal, operational, and regulatory challenges in the past year, educational institutions are being asked to do more with less, while meeting the increasingly high expectations of all stakeholders. These challenges have necessitated focused and rigorous fiscal management, monitoring of endowment spending policies, and more critical reviews of both short and longer term financing options, among other responses. Simultaneously, expectations are rising for institutions to make investments in areas such as student aid and service delivery, information systems and security, and compliance. The nature of these issues, individually and in the aggregate, requires a proactive approach to planning in order to maintain a competitive advantage in an ever-growing global education market. This briefing, the product of PricewaterhouseCoopers' Assurance, Tax and Advisory staff specializing in higher education, was created to share our insights on several of the key issues facing large research and educational institutions and the challenges of responding to them, both now and in the foreseeable future.

As a leading auditor and advisor to the higher education and not-for-profit industry, PricewaterhouseCoopers has had the opportunity to work with many of the nation's premier institutions in addressing the most pressing challenges educational institutions face today. While each client we serve is faced with its own, unique set of issues, all educational institutions are currently contending with a number of shared challenges.

A number of the more prominent issues in the higher education sector today, along with our perspective on each of these issues, have been highlighted in this briefing. Our conclusions are based on our firm's experience in working with universities and colleges nationwide to provide a range of audit, tax and advisory services. Our position as a market leader in providing these services to the higher education sector gives us a view into industry issues, and we capitalize on this insight to the benefit of our clients. With industry professionals in accounting and auditing, regulatory compliance, risk management, exempt tax services and advisory services, we are able to deliver to our clients a clear understanding of critical issues and guidance from experienced teams in the field.

This briefing is not meant to be comprehensive in nature. Drawing upon our understanding of the diverse nature of higher education institutions that have complex educational, research, and clinical activities, we offer this summary as a broad platform for discussing these topical issues in a proactive and collaborative manner.

We hope you find this briefing useful. Please do not hesitate to contact Tom Gaudrault at (617) 530-4757 or me at (646) 471-4253 with any questions or comments.

John Mattie
National Higher Education and Not-for-Profit Practice Leader

Oversight of Financial Strategies

►Background

The economic events of the past year have placed a strain on the financial resources of many colleges and universities. As a result of budgetary shortfalls and liquidity concerns, institutional priorities and strategic plans are being revised on a frequent basis. Important financial decisions should be based on real-time management information and reliable financial reporting that is provided to key decision makers, including senior management and the Board of Trustees. This reporting includes not only current and forecasted balance sheet and operating statement detail, but also cash flow analysis and budget scenarios based on market projections.

In addition to more frequent internal reporting, a sharper focus is being placed on how internal financial management reports used to manage an institution, align with external financial reports given to lenders, rating agencies, federal funding providers, and others. This alignment between internal and external reporting has resulted in institutions taking a fresh look at the integrated management reporting packages utilized to manage financial strategies, and adapting appropriately to effectively meet the needs of all users.

►Impact on Educational Institutions

Readily available financial information is being requested by many constituents. This is requiring senior management, including the President, Chief Investment Officer, Chief Business Officer, Development Officers, and other members of senior management to work more closely together than ever before in developing, managing, and monitoring financial strategies. In turn, Trustees are more engaged in the development of financial plans and strategies, as well as overall monitoring of the budget process, and actual financial results.

In response to this heightened scrutiny on financial reports, institutions are determining the most effective way to present information to multiple users to assist in managing and monitoring institutional strategies. Crafting of financial dashboards — which include metrics, key ratios and comparable data — is evolving to fulfill the needs of internal and external parties.

Effective multi-year budgeting is receiving a greater level of attention, and the focus is shifting away from solely evaluating the operating budget to a process that includes all financial resources and expenses including restricted funds, capital outlays and investments. In regards to restricted funds, these are being more closely analyzed to determine which can be utilized to assist with subsidizing the operating budget. In line with this focus on overall budgeting, Trustees and external parties are requesting greater transparency surrounding all institutional cash inflows and outflows.

Cash flow forecasting and balance sheet projections are deemed more critical than ever as key components of a financial reporting package. Communication between multiple departments within an institution, including Investment, Business and Development Officers, is imperative to determine appropriate cash flow projections associated with such items as investment capital calls and lock-up periods, anticipated annual gift funds, construction financing, research funding, medical service billings, and other sources and uses of cash.

The frequency of financial reporting has led more institutions to prepare quarterly financial statements on a basis consistent with year-end reporting, or a modified version of generally accepted accounting principles (GAAP). A formal reconciliation aligning internal management reports with external GAAP financial statements is evolving as a best practice. Quarterly reporting and reconciliation are often presented to the Finance and/or Audit Committee of the Board of Trustees at interim periods during the year.

►PwC Perspective

Creating a culture of accountability whereby institutional objectives are communicated frequently, and all parties are involved in monitoring the objectives requires timely budgeting and financial reporting of results. Involvement of key members of senior management and Trustees with respect to information flow, monitoring of financial plans, and actual results is imperative given the challenges in the uncertain economic climate. Developing financial plans based on the concept of "all resources and expense reporting", rather than focusing strictly on the operating budget allows for broader knowledge of the overall operations of the institution. Creating timely and appropriate cash flow analysis, operating statements, balance sheets and financial dashboards will lead to better information sharing and create data that will allow for timely monitoring of the financial situation of an institution.

To enhance discipline and control around financial accountability, consideration should be given to preparing interim GAAP financial statements on a periodic basis during the year and establishing tools to align internal management reporting to external financial statements. Along with this, sensitivity analyses and contingency plans should be developed and shared with the Board of Trustees on a periodic basis.

Endowment Payout Considerations

►Background

Educational institutions design and utilize spending policies for their endowment funds to provide for current spending, while preserving an endowment's corpus and supporting spending in perpetuity. Consistent with institutional policies to periodically review asset allocation, it is also important to review spending policies. The two policies are interdependent, and a balanced interaction between the two is critical to the long-term success of any endowment.

One of the primary objectives that governs the management of most endowments is the pursuit of real (inflation-adjusted) purchasing power of the corpus over time. If this objective is met, it should enable an educational institution to achieve a relatively constant level of real spending.

Over the past two decades, many educational institutions have been under significant pressure to grow spending by more than the increase in the underlying rate of inflation. This pressure to grow spending is even greater during weak periods in the economy when other sources of funding such as gifts and grants decline. These periods tend to coincide with weak periods in the financial markets, which places endowments, especially those with an equity oriented investment strategy, under additional stress at the exact time they are the least equipped to handle it.

Most educational institutions utilize a market value based spending policy. This policy typically does not generate stable and predictable spending levels. During years of growth, a market value based spending policy will produce more total dollars for the institution, but during years of losses, spending can quickly retract. This can make the annual budgeting process for the endowment difficult. Institutions whose spending policies rely solely on the beginning market value each year can subject themselves to more volatile spending levels from year to year. A partial solution to the problem has been to adopt a moving average market value which reduces spending volatility, but does place additional pressure on the corpus during declining markets.

Some institutions are adopting spending policies that are tied to annual inflation rather than market returns, or a combination that considers an inflation adjusted amount of a percentage of the previous year's spending and market returns. These methods allow spending to grow in relationship to a consumer price index and results in less spending over the long term than by using a percentage of the asset value, as inflation is expected to grow at lower rates than long-term market returns.

► Impact on Educational Institutions

Current market conditions are having a significant impact on institutions' endowment payout rates. On average, spending rates at educational institutions are between 4% and 6% of the endowment's value each year. Many institutions are revisiting their endowment spending rate and determining whether changes need to be made.

Educational institutions are experiencing several conflicting considerations when establishing or changing their endowment payout rates. Institutions that heavily rely on endowment spending for their operating budget are experiencing significant deficits in the current economic environment. These institutions are in the process of determining how to reduce the deficit through such means as identifying other potential revenue sources, decreasing operating expenses, increasing the endowment payout rate, or borrowing to finance annual operating needs. Boards are focusing on maintaining long-term purchasing power during a time of significant investment declines and "underwater endowments" (i.e., when the fair market value of an endowment fund has fallen below the original corpus of the gift). Adding to the focus on endowment spending, the Senate Finance Committee, through letters initiated in January 2008, expressed concern surrounding the exponential cost increases of higher education during a period of significant growth of college endowment assets. There are many critics that believe colleges and universities should be required to have a legally mandated payout rate of at least 5% of the endowment's market value, which correlates to the amount private foundations currently pay annually. This attention and focus was before the market declines over the past year but still remains an unresolved Senate Finance Committee agenda item. Finally, some states have recently enacted the Uniform Prudent Management of Institutional Funds Act (UPMIFA). Some states' enacted version of UPMIFA includes a presumption of imprudence as to spending rates in excess of 7% per annum.

►PwC Perspective

The significant investment returns during 1988 to 2007 have resulted in higher "true dollar" levels of spending and larger operating budgets. Many institutions are making tough decisions in order to effectively manage their operating budgets. Communication between senior administration and the Board is imperative. To respond to this, a prudent and standard best practice is establishing a Board Committee made up of members of the Budget, Finance, and Investment Committee(s) to prioritize and examine how annual expenditures and strategic initiatives will be funded in the short and long term, and what role endowment payout rates play over those short and longer term periods.

This is an opportune time for institutions to revisit the method and process of its spending rate policy and calculation. Educational institutions may want to consider alternative calculation methods for spending. Management should "stress test" these varying methods to determine the financial impact to the institution under various budget scenarios over a shorter and longer timeframe as part of their financial planning.

All institutions have been impacted by the economic downturn and declines in their investment portfolios. The goal of all educational institutions is to continue their central operating mission and to avoid budget deficits. This is not a new issue. There is no magic formula on how to handle the endowment payout rate. What is clear however is the role of endowment spending in supporting both recurring operations and strategic initiatives, both in the short and long term, needs to be assessed as an institution develops its financial plans in response to the economic events over the past year. How an institution determines its endowment payout formula in support of such plans requires careful consideration as an institution balances short term needs with longer term responsibilities.

Liquidity and Financing Considerations

►Background

The economic challenges over the past year have affected colleges and universities as much as any other institutional investor, and possibly more given the reliance on investments to fund operations and student borrowings to finance tuition. Major ratings agencies have projected sharp deterioration in the financial outlook for private colleges in the next two fiscal years.[i] Rating agencies have always emphasized strong liquidity as a measure of high institutional performance and the ability to repay debt obligations, but liquidity has become perhaps the most significant factor in determining and maintaining ratings.

The concerns of rating agencies in assessing higher educational institutions relate strongly to liquidity and sustainability of operations, including:

- Less flexibility on the pricing of tuition and possible tuition declines, placing greater stress on funding of operations through investments;
- Declines in enrollment and a shift to lower-cost institutions due to financial concerns of students and their families;
- Delays in capital investment and increases in deferred maintenance;
- Increases in the proportion of debt relative to financial position;
- Decreases in philanthropy; and
- Reductions in state appropriations.

► Impact on Educational Institutions

A convergence of factors related to the global economic challenges over the past year directly affected the ability of higher education institutions to access the capital markets and maintain operating liquidity. Additionally, investment earnings have deteriorated precipitously, since average aggregate gains of 17% in fiscal year 2007.[ii] Some attribute the volatility of the earnings to a general move in the industry toward more aggressive investment in illiquid assets, such as hedge funds, private equity and property. The historic returns on this strategy outperformed even the top percentile of corporate pension funds; however, certain risks associated with this investment model left institutions vulnerable when the downturn hit, particularly with respect to liquidity.[iii] Certain institutions failed to arrange credit lines to manage cash needs, and some endowments were simply too small to handle the diversification required for the successful implementation of the investment strategy. The loss of endowment value directly affected the ability of higher education institutions to maintain their existing ratings and access the capital markets.

The economy has also taken a toll on students, their families, alumni and other donors, resulting in decreased philanthropy and stress on tuition revenues. Fiscal year 2008 saw a decline of 2% in total charitable giving within the U.S., but gifts to educational institutions were down nearly 9%, adjusted for inflation.[iv] Additionally, industry sources suggest there will continue to be a migration of students to lower-cost alternatives, causing implications for enrollment and sustainability for many higher-cost institutions.

Public educational institutions and institutions with academic medical centers had their own unique financial challenges. As of April 2009, at least 36 states had cut or announced proposals to reduce higher education spending because of their own looming deficits.[v] The trend may cause increasing operational concerns for state-sponsored institutions. However, their access to capital may be less affected because rating agencies view state-sponsored institutions as more insulated from economic downturns because they are less dependent on endowments and are accustomed to weathering budget constraints.

Academic medical centers have specific challenges as well. In many cases, the clinical operations have provided cash to support the academic and research missions. Currently, the financial condition of many healthcare providers nationwide has deteriorated, and the healthcare debate currently taking place in Congress leaves great uncertainty about the future impact of hospital funding. In the best of times, academic medical centers have been able to exploit their higher education endowments, combined with the cash and margins of healthcare providers, to obtain solid ratings and access to capital. In the current environment, academic medical centers are likely to feel capital constraints from both directions.

Across the U.S., educational institutions are more actively managing their investment strategies, particularly regarding alternative investments and more illiquid investments, as well as their impact on liquidity. There is also a greater focus on globalization within the investment strategy by increasing investments in foreign markets to absorb the declines in the U.S. economy. Institutions are employing a global perspective when making investment decisions and are becoming more flexible in order to react to market conditions as they occur.

►PwC Perspective

Financial strength of educational institutions is defined primarily by the balance sheet and liquidity, both of which will continue to face significant challenges as the economy begins its slow recovery. Rating agencies have spelled out the factors that are most likely to lead to downgrades. Broad factors related to financial stability and liquidity include those already discussed. Additional concerns relate to:

- Transparency and timeliness of financial reporting and disclosure;
- Active involvement of governance and oversight; and
- Effectiveness and timeliness of adminstration's response to and understanding of financial and operational issues.[vi]

A deepening divergence between financial stability and capital access for the "haves" and the "have nots" appears to be emerging. According to the Education Department's fiscal year 2008 test of financial strength, more than 100 institutions failed based on the composite score of debt load, expenses relative to income and overall resources.[vii] Based on early fiscal year 2009 trends, that number is likely to worsen. More colleges and universities will be faced with the need for a line of credit to support the aid they award, at a time when they are least likely to be able to access liquidity facilities at reasonable rates. In recent years, troubled institutions have closed or merged with larger entities. The number of troubled institutions is likely to increase, which may lead the industry to see more merger and acquisition activity.

Despite the economic turbulence of 2009, higher education institutions are beginning to access the capital markets again. Several well-publicized issuances in late fiscal year 2009 contained not only funding for capital projects, but also portions for working capital and operations. While the re-entry to the capital markets is encouraging, it appears to be limited to the financially strong, and at higher interest rates than historical rates.

Administration and Trustees can implement a number of practical actions, not only to demonstrate their strengths to the capital markets but also to bolster their long-term sustainability:

- Institutions should focus on strong management of liquidity and investments, with an emphasis on understanding the risks associated with various models and planning for the downturns.
- Institutions must not only focus on short term issues, but also long term strategy. A clearly articulated strategy supported by a flexible business plan, with contingencies and exit strategies, can help guide operational and capital planning. Moreover, the business plan will provide the basis for active and timely monitoring of operational and financial results. The ability to monitor results, disclose concerns, and respond quickly to challenges will be viewed favorably by rating agencies and credit markets, even if the financial position is not as robust as it has been historically.
- Given the deepening division between the "haves" and the "have nots," the financial fallout of the economic events over the past year may generate more opportunity for business expansion through acquisition. Higher education strategies should consider topics such as acquisition as a means to broaden the academic mission, whether through affiliations or through mergers.
- In terms of accessing the capital markets, the right story can be as compelling as the right numbers. Institutions that can articulate their strategic vision, their connection to planned capital investment, and their demonstrated ability to respond to fiscal pressures will be able to access capital at the more favorable rates.

- Finally, the use of capital should be appropriate to the source. This means that colleges and universities will have to demonstrate not only to the capital markets, but also to themselves, that the uses to which they put capital dollars bolster long-term sustainability and support strategy.

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[i] Source: Moody's Fiscal Year 2008 Private College and University Medians: Early Signs of Sector Weakening in 2008; Sharp Deterioration Expected in 2009 Data, Moody's Investor Services, June 2009.

[ii] Source: Educational Endowments' Investment Returns Were -24.1% in the Last Six Months of 2008, www.commonfund.org.

[iii] Source: Ivory-Towering Infernos: America's Universities Have Seen Billions of Dollars Go Up in Smoke, www.economist.com, December 11, 2008.

[iv] Source: U.S. Charitable Giving Estimated to Be $307.65 Billion in 2008, Giving USA, a publication of Giving USA Foundation, researched and written by the Center on Philanthropy at Indiana University, June 10, 2009.

[v] Source: How Are State Budget Cuts Affecting Spending for Higher Education?, www.universityparent.com, April 6, 2009.

[vi] Source: Moody's Outlines Factors That Could Lead to Credit-Rating Downgrades, Moody's Investor Services, May 1, 2009.

[vii] Source: More Than 100 Colleges Fail Education Department's Test of Financial Strength, The Chronicle of Higher Education, June 12, 2009.

Revenue Enhancement and Expense Reduction Initiatives

►Background

Although the demand for higher education has increased significantly over the past two decades, institutions are faced with a number of financial challenges. Among these challenges are increasing operating costs, growing expectations from students for additional services, legislative pressures for public institutions and the fluctuations of public resources to support student and research activities. Additionally, with high unemployment and financial uncertainty, more and more families are seeking less costly alternatives for higher education, including public and community colleges. These and other factors are requiring institutions to look at more cost efficient ways of delivering service, and seek alternative revenue-generating opportunities.

► Impact on Educational Institutions

The most recent Moody's analysis of the industry says that "higher-education institutions are facing a range of challenges in the next year and a half." These challenges will impact the operations of private and public institutions and include:

- Declining value of endowments – According to NACUBO's 2008 endowment survey results, higher education endowments experienced an average rate of return of -3.0% for fiscal year ending June 30, 2008. Since then, endowments have been down by as much as 35%.[i]
- Availability of federal and state funding – state appropriations, for public institutions, increased by approximately 7.5% from fiscal year 2007 to fiscal year 2008. However, based on preliminary data, state funding grew by only 1% nationally for fiscal year 2009.[ii] The current administration's American Recovery and Reinvestment Act will increase federal research funding over the next two years. However, record federal spending to stimulate the economy will increase the federal budget deficit, which will impact the availability of federal funds for research over the long term.

Senior management and their Boards are developing focused financial plans that consider the budgetary and operating implications of the above factors. These plans contemplate the implementation of certain short and longer term tactical strategies to reduce cost, improve efficiency of operations, and explore alternative revenue sources.

►PwC Perspective

Institutions should develop a two-pronged approach focused on cost reduction and revenue enhancements. This approach should identify measurable actions in the short term and plans to sustain such actions. Sensitivity analyses and plans should also be developed to identify other courses of action, should cost reduction and revenue enhancements not be achieved.

Specific cost reduction and revenue enhancement actions have included, and will continue to include, the following:

Cost reduction - Sustainable cost reduction is a systematic approach to eliminating cost through the use of strategically tailored industry leading practices surrounding people and organization, effective use of technology, and efficient and effective processes geared towards specific actions and results. A focus on processes requires a cultural change that is only achieved through leadership, communications, clear accountabilities, and execution and performance measurement.

The cost reduction tactics that institutions will continue to pursue have reached into all areas of operations, including human resources, academics, financial operations, facilities and others.

Within human resources, certain colleges and universities have acted by eliminating raises for tenured faculty and staff whose salaries exceed certain dollar thresholds and have provided modest salary increases for untenured faculty and lower-paid staff. Other institutions have held flat salaries for faculty and exempt staff for the next academic year and have initiated voluntary early retirement programs for others. Some institutions have created leadership committees to review and approve new searches for term, temporary or regular staff members, as well as for any necessary utilization of consultants, temporary employees, and independent contractors proposed in lieu of staff hiring.

In the academic program area, institutions have discontinued unnecessary or outdated programs while others have attempted to predict program demand based on historical trends and demographic data. Other institutions have implemented earlier payment deadlines to help forecast demand and provide a better picture of the classes that are filling up and which ones may be at risk of not attracting a sufficient number of students to enroll.

Many institutions have revisited their capital projects and considered delaying physical expansions and scaling back on others. Other institutions are redirecting capital dollars to reduce operating costs.

Along the supply chain, institutions are consolidating and streamlining purchases and are re-evaluating contracts with vendors and updating preferred vendor lists. Certain institutions have implemented purchasing cards to help staff obtain purchases faster and reducing the number of checks produced.

Institutions are also implementing energy management improvement programs, such as closing certain administrative buildings during breaks to capture energy savings. Other institutions are reconfiguring standard desktop computers to decrease the purchase price and to utilize a new energy-efficient power supply that will reduce desktop energy consumption.

Revenue Enhancement - This is usually a longer-term approach that can aid in averting or reducing the severity of a fiscally challenging situation. Organizations across all industries are taking efforts to address growth opportunities in a rebounding economy with a focus on increasing cash flow while holding down associated operational and administrative costs, streamlining processes and improving performance across the entire organization.

A number of institutions are focused on enhancing revenue streams by targeting the following: expanding globally, expanding fundraising, and increasing the number of proposals submitted to sponsors to increase research revenues. Others are focusing on collecting revenue due to the institution, while minimizing uncollectible accounts. These institutions are being more diligent in managing accounts receivable aging.

Many institutions are expanding their programs globally and adding satellite campuses abroad to respond to the increasing global demand for higher education. Globalization brings its own set of operational and financial challenges to the business office. An institution needs to determine how to price tuition (considering U.S. and foreign currency fluctuations); how to comply with a myriad of tax and regulatory requirements in other countries; and what additional people and processes are necessary to support global education delivery structures. Educational institutions need to develop administrative structures and processes to support the expansion, such as a formalized global operations team or dedicated individuals focused on international operations.

Certain institutions are reviewing patent revenue relationships and streamlining their portfolio of rented office and storage space while others are identifying new revenue opportunities and enhancing existing revenue from external groups' fees for spaces and services across campus. Many institutions are evaluating fees and charges within their organizations to identify efficiencies through simplification of existing processes.

Institutions will need to continue to focus on cost reduction and revenue enhancement strategies, including those above, to generate the resources necessary to maintain effective operations and initiate critical strategies. Continued long-term focus will be required to achieve the desired budgetary effects in the current economic situation.

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[i] Source: National Association of College and University Business Officers publication, 2008 NACUBO-Commonfund Endowment Study Follow-up Survey, http:www.nacubo.org/documents/research/NES2008Follow-upSurveyReport.pdf

[ii] Source: State Higher Education Executive Officers (SHEEO) publication, State Higher Education Finance Early Release FY2008, dated February 9, 2009.

Current Regulatory Environment

►Background

The current regulatory focus on educational institutions, particularly with respect to compliance, remains intense. The impact of several of the more recent initiatives that commenced last year, including the redesigned 2008 Form 990 and the new Electronic Municipal Market Access system (EMMA), will be felt fully this year. Other areas of attention, such as conflicts of interest and effort reporting, will likely continue at a fast pace as well. Additionally, academic medical centers are faced with the Recovery Audit Contractor (RAC) initiative. This program established by the Centers for Medicare and Medicaid Services is an audit initiative designed to identify and recover overpayments made to providers of healthcare services. According to a recent status report, Medicare has recovered more than $1 billion through the RAC program since 2005.

In light of such regulatory requirements, educational institutions are under on-going pressure to demonstrate their compliance and accountability. The impact of actual or perceived failure of an institution to identify and manage compliance functions could lead to a damaged reputation among various stakeholders and potential administrative and financial sanctions imposed by regulators.

The following is a brief summary of selected regulatory matters where educational institutions are currently focusing resources to ensure compliance and to manage the risks associated with non-compliance.

The Redesigned 2008 Form 990

Educational institutions will begin filing the redesigned Form 990 for their fiscal 2009 year. Responding to Congressional pressure for non-profit accountability, the IRS redesigned the Form 990 to achieve greater transparency and compliance from reporting organizations. Key focus areas of the redesigned Form 990 include governance and management; compensation; transactions with the reporting organization; relationships among certain individuals; and tax-exempt bonds. While many of the new questions on the Form 990 are not mandated by tax law, they highlight what the IRS and others consider to be best practices for tax-exempt organizations. The IRS has announced that they are revisiting their examination selection criteria based upon responses to the new Form 990.

Tax-Exempt Bond Compliance

In their work plan for fiscal 2009, the IRS's Tax Exempt Bonds (TEB) division has highlighted Internal Revenue Code Sec. 501(c)(3) bonds as having a high risk for noncompliance. Sec. 501(c)(3) bonds were categorized as high risk based on information gathered through the IRS's 2008 Tax-Exempt Bond Compliance Questionnaire and based on the low level of Voluntary Closing Agreement Program requests relating to post-issuance compliance deficiencies. As a result of the high risk categorization, TEB has allocated additional resources for examinations of bonds held by Sec. 501(c)(3) organizations. Organizations are challenged in these difficult economic times to maintain compliance with bond covenants associated with their external borrowings.

Electronic Municipal Market Access

The Securities and Exchange Commission has mandated the use of the EMMA system for continuing disclosure filings. Effective July 1, 2009, EMMA has become the sole Nationally Recognized Municipal Securities Information Repository (NRMSIR) for filing municipal bond official statements, annual and quarterly financial information and material event notices, replacing the four existing NRMSIRs. Similar to the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system that makes annual, quarterly, and material events information of SEC registrant companies publicly available, EMMA will make municipal disclosure information available to the public via an internet website at no cost.

Effort Reporting

Time and effort reporting continues to be a challenging area, particularly for organizations that receive funding from the Department of Health and Human Services (HHS) and the National Science Foundation (NSF). In most federal awards, personnel costs, including direct labor charges, fringe benefits, and the related indirect costs, represent the largest charges to the government. Federal agency Offices of Inspector General (OIG) and the Department of Justice are aggressive in bringing charges for non-compliance with labor cost requirements and for overcharging for labor costs on federal awards. The OIG work plans, which set the direction for the OIG's audits, include review of effort reporting, administrative and clerical salary charge-backs, support for cost transfers and graduate student compensation.

Faculty and Institutional Conflicts of Interest

Institutions have been required under federal regulations to implement research conflict of interest policies and procedures to protect the integrity and objectivity of research efforts. Federal requirements have historically required that institutions identify, manage and disclose conflicts of interest among research faculty to sponsoring agencies. Recently, the management and reporting of conflicts of interest have been called into question. Senator Grassley has contacted several organizations over their conflict of interest policies and has initiated investigations of specific conflict of interest matters involving several scientists and institutions. At issue is the failure by scientists, investigators, and researchers to disclose conflicts accurately and timely, and the inability of institutions to identify and accurately report such conflicts. Senator Grassley additionally has expressed concern that the National Institutes of Health does not receive sufficient information concerning specific conflict of interest matters reported to allow it to adequately make conclusions regarding the severity of reported conflicts and the institutions' resolution of the specific matters.

From these recent actions by Senator Grassley and the disparity of reporting noted in the audit findings, new legislation was proposed by the Senate Appropriations Committee to "step up" oversight of financial conflicts of interest among organizations. The draft legislation would require drug and device makers to disclose payment amounts greater than $500 per year to doctors, scientists and researchers in a National Registry. In the future, it is possible that organizations and sponsoring agencies will be mandated to verify disclosure accuracy through this National Registry. Several states also have enacted or proposed legislation that requires enhanced reporting of compensation from pharmaceutical companies to medical professionals in an effort to promote greater transparency and accountability to the public.

International Activities

Increasingly, colleges and universities are engaging in collaborations with institutions in foreign countries. These collaborations may include joint education and/or sponsored research programs as well as consulting arrangements. Some involve the granting of dual degrees within the foreign jurisdiction. Although educational institutions may be considered tax-exempt for US income tax purposes, they may be subject to taxes and a variety of other compliance and reporting requirements in foreign jurisdictions.

Internal Revenue Code Section 403(b) Plans

Effective for 2009, Sec. 403(b) plans are subject to annual Form 5500 reporting and audit requirements similar to Sec. 401(k) plans. On or before December 31, 2009, the Sec. 403(b) plan sponsor must adopt a written plan that is intended to satisfy the requirements of Sec. 403(b) (including the financial regulations) effective as of January 1, 2009. Even if it does not formally adopt a written plan until the end of 2009, the sponsor must operate the plan in accordance with a reasonable interpretation of Sec. 403(b), taking into account the financial regulations. Also, before the end of 2009, the sponsor must make its best efforts to retroactively correct any operational failure during the 2009 calendar year to conform to the terms of the written plan, consistent with the general correction principles set forth in the Employee Plans Compliance Resolution System.

► Impact on Educational Institutions

Many educational institutions are challenged to respond to increasing regulatory requirements. The items noted above are only a select few of the many rules and regulations with which educational institutions have to comply. Compliance with these requirements for many educational institutions has been an ongoing challenge and has strained internal resources. Colleges and universities are addressing the substantial requirements by determining the need for implementing new policies and procedures and modifying existing financial and information systems to accommodate new data collection. Additional "compliance internal controls" and investment in personnel may be necessary to ensure and maintain ongoing compliance.

Institutions have also been assessing their policies and procedures relating to tracking, reporting and communicating information related to the charitable benefit they provide the community. Disseminating information in an easily understandable format for interested parties (creditors, donors, regulators, etc.), in addition to proactively responding to any inquiries or comments, continues to be important in the current environment.

►PwC Perspective

The attention being placed on educational institutions and the heightened expectations for improved accountability and compliance are ongoing and not expected to subside in the near future. As a result, educational institutions will need to continue their focus on enhancing internal controls over compliance. In the past, institutions often substantially satisfied regulatory requirements by holding individual schools and departments accountable for compliance, rather than placing responsibility on the institution's central administration. While decentralized accountability for compliance may not be adequate to ensure institutional compliance, centralized compliance is a costly endeavor. Nonetheless, the establishment of an organizational structure that supports and promotes accountability for institutional compliance is becoming a more common and prudent response to the continued regulatory requirements. Any increased effort in this area will likely require an additional investment in compliance resources, which unfortunately coincides with a period of tight budgets and an uncertain economic climate.

In addition to the development of an organizational framework for institutional compliance, educational institutions must continue to develop other proactive responses to the myriad of regulatory initiatives imposed on them in order to keep up with the pressure from regulators. Consideration should be given to the following steps to enhance overall compliance and reduce the financial, operational and reputational risks associated with non-compliance:

- Review current policies and procedures at the "local" school, department, and/or unit level. Consider how the results can be summarized in a manner suitable for reporting compliance results back to central institution management.
- Review Board compliance oversight polices currently in place and strengthen such oversight as needed to ensure that compliance controls are receiving an adequate level of attention.
- Consider educating key stakeholders at the institution on regulatory requirements and compliance initiatives.
- Consider utilizing information technology reporting tools to identify compliance exceptions that can be reported centrally and remediated on a real-time basis.

Enhanced Transparency and Accountability

►Background

Transparency has different meanings in different situations—clear, easily analyzed, reliable, timely—but in the world of financial reporting, it means all of these together. In 2005, PricewaterhouseCoopers published a paper, *Enhancing the Transparency of Financial Reporting*, dedicated entirely to addressing the information different users of financial statements of a higher education institution might desire to have included, the reasons they want the information, and ways to satisfy their needs. Since 2005, there has continued to be a significant focus by the Financial Accounting Standards Board (FASB), regulators and other parties to require additional transparency in external financial reporting. Whether it is disclosures regarding fair value measures, pensions, derivative activities, or net asset classifications, all institutions are finding the minimum amount of information required to be disclosed, and the related effort to collect and report that information in their financial statements, continuing to increase. Primary users and other stakeholders, including bond rating agencies, donors, and other users of the financial statements, are asking for more information that provides a deeper understanding of an institution's liquidity, total on- and off-balance sheet financing, and exposure to credit and market risks with respect to the investment portfolio, among many other items.

► Impact on Educational Institutions

As the availability of credit has become more restricted and investment portfolio values have decreased, many institutions have found their normal sources of liquidity have diminished significantly. Bond rating agencies are assessing institutions in a different light, and are seeking more information to assist them in their rating processes. For instance, Moody's issued two special comment reports in March and April 2009, *Moody's Developing New Liquidity Ratios for U.S. Universities, Hospitals, & Other Not-for-Profits*[i] and *U.S. Colleges and Universities Rating Roadmap*: *Focus on Special Risks During Recession & Credit Crisis,*[ii] addressing their concern with the current level of transparency in Institution's financial statements.

The first report focuses on new liquidity ratios Moodys has developed. Given the recent strain on cash, as well as the inability to quickly liquidate long-term investments, Moodys is focusing on institutional liquidity and believes that clearly identifying unrestricted cash and investments, as well as any potential restrictions on the liquidity of investments, are critical components of their evaluation of an institution's financial health. This level of disclosure is currently not included, nor required, in external financial statements. The second report by Moodys reaffirms its measures of financial stability (e.g., selectivity and yield rates, expendable resources to debt, unrestricted cash to puttable debt, and the percentage of variable rate debt (before interest rate swaps) to total indebtedness). Additionally, the report addresses mitigating factors that institutions can employ to respond to their current financial situation, including re-evaluating capital plans and operating budgets, restructuring debt to fixed rate, replacing letters of credit counterparties with more financially sound counterparties, terminating interest rate swaps with collateral posting requirements, liquidating long-term investments to generate liquidity, and revisiting asset allocations.

In addition to rating agencies, donors are also requesting increased transparency surrounding the gifts they make. Specifically, donors are requiring more information be made available about the ultimate use of their donations. In several situations, donors have requested the return of their gift when they believed it was not being used for the purpose intended. To prevent this, institutions are implementing additional procedures to inform donors of the budgeted expenditures to be charged to their gift and actual results. Donors are also expressing concern about how their contributions are being invested, including understanding the spending policies of an institution. Through a recent FASB Staff Position, additional disclosures are now required on endowment fund activities and spending policies.

►PwC Perspective

There is no one-size-fits-all answer or approach to what constitutes effective financial transparency, beyond required disclosures, in the external financial statements. Each institution must evaluate the needs of the users of its financial statements, weigh the pros and cons of providing additional information, and make informed decisions on how to enhance its financial statements.

Institutions should consider including additional disclosures in their financial statements regarding liquidity, such as a table with timeframes of how long it would take to liquidate certain investments. Additionally, while many of the financial measures utilized by rating agencies can be calculated from financial statements, institutions should take a fresh look at other information that may be helpful to external users. While it is not realistic to include disclosures in the financial statements that address individual donor gifts and how they are utilized, it may be useful for institutions to provide an understanding of the funds management processes that ensure that the instructions of the donors are being followed.

As financial reporting transparency requirements continue to increase, institutions should critically assess what additional information may be helpful to external users to understand and provide helpful perspective as to its financial health and strategies, both today and in the future.

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[i] Source: Moody's U.S. Public Finance - Disclosure of Liquidity Information for Universities is Weak. Special Report, March 2009.

[ii] Source: Moody's U.S. Public Finance - U.S. Colleges and Universities Rating Roadmap: Focus on Special Risks During Recession & Credit Crisis. Special Report, April 2009.

The Impact of the Stimulus Package

►Background

In an attempt to invigorate a faltering economy marked by rising job losses, falling GDP and uncertainty in the capital markets, President Obama signed the American Recovery and Reinvestment Act (the "Recovery Act") of 2009 on February 17, 2009. The purpose of the Recovery Act includes preserving and creating jobs to promote economic recovery, providing investments needed to increase economic efficiency, and to assist those most impacted by the recession. The Recovery Act provides $787 billion of funding with a majority going towards existing programs. Three quarters of the package is intended to enter the economy by September 2010. The package intends to make a short and long term impact in investments that create jobs and provide future resources through building infrastructure, promoting science and education, improving health care, and increasing clean energy use.

President Obama was clear that portions of the stimulus package must focus on education. Although House and Senate versions of the bill included different measures of aid for students, infrastructure, scientific research and job training, the final package will generally benefit all institutions of higher education in one form or another. Those institutions focused on research and development should see increased federal awards from a variety of different agencies, while student financial aid recipients will benefit from increased Pell and Work Study funding from the Department of Education.

► Impact on Educational Institutions

The Recovery Act has provided many federal granting agencies with additional financial resources that will impact higher education institutions. Amongst these federal agencies are the following:

- The Department of Education will increase the maximum Pell award for eligible students from $4,850 to $5,350 and provide $200 million towards work study programs.

- The National Science Foundation has increased funding by $3.0 billion, including $2.5 billion for research, $400 million for infrastructure and $100 million for education.

- The National Institute of Health has been allotted $10 billion, including $8.5 billion for research and $1.5 billion for university research facilities.

- The Department of Energy has been awarded $2 billion for research.

Additionally, academic medical centers will see the effects of the stimulus package through the federal government's investment of $36 billion in Medicare and Medicaid providers between 2010 and 2017. A key goal of the Recovery Act is to reduce long-term costs by modernizing healthcare through the use of information technology. Of the $36 billion stimulus funding, $33 billion is expected to flow to healthcare providers, with the majority of the funding to those that use government-certified Information Technology systems, including electronic medical record systems.

The Act also created a new form of bonds known as Build America Bonds ("BABs"). These bonds were created in the stimulus legislation to help state and local governments (and related entities) raise money for building projects by making it significantly cheaper for them to issue taxable bonds. The Act created two types of BABs. The first type provides a federal subsidy to investors equal to 35% of the interest payable by the issuer ("Tax Credit BABs"). The second type of BABs provide a direct federal subsidy that will be paid to state and local governments in an amount equal to 35% of the interest ("Direct Payment BABs"). Both types of BABs must be issued before January 1, 2011. Public universities have started to utilize these bonds to fund various construction projects.

The Act holds institutions receiving funding to a high standard of accountability and transparency with respect to the utilization of funds received, including additional federal reporting requirements placed on institutions receiving Recovery Act funding. Institutions must separately track and monitor recovery funds, as such funds cannot be commingled with non-Recovery Act funds. Additionally, the Recovery Act provides additional funding to federal agencies for performance of audits and reviews to assure accountability, consistency, controls, and transparency. These requirements will place a greater burden on institutions in receipt of Recovery Act funds to assess how such funds complement existing research and other institutional strategies, and what level of institutional infrastructure and resources are necessary to manage and monitor expenditures funded through the Recovery Act.

►PwC Perspective

Institutions will need to be proactively strategic in identifying areas in which additional funding can be utilized and submit proposals to federal agencies to take full advantage of the Recovery Act funds.

As institutions begin to receive additional funding, an evaluation will need to be performed of the current organizational and administrative framework (e.g., people, processes, and information systems) required for effectively monitoring and reporting expenditures made with Recovery Act funds. Institutions should consider:

- Appointing one individual to coordinate and monitor all Recovery Act related activity at the institution. This must include frequent monitoring of the Recovery Act website as the federal compliance rules and guidelines are fluid, and are being developed and published in draft form for retroactive application.

- Reviewing policies and procedures in place to monitor Recovery Act grants from non-Recovery Act grants and identifying any special requirements associated with the Recovery Act funds.

- Ensuring all funds provided by the Recovery Act are distinguishable from non-Recovery Act funds in financial systems, business systems (i.e., grant and contract writing systems), and reporting systems.

- Reviewing compliance programs to ensure they consider the unique aspects of Recovery Act compliance requirements. For example, institutions will be required to provide, on a quarterly basis, an estimate of the number of jobs created, and the number of jobs retained, as a result of the support of Recovery Act projects.

Institutions that are affiliated with academic medical centers should take additional steps to determine the impact of a nationwide health information technology system by reviewing the following:

- Analyzing the potential level of incentives and determining which factors will impact those payments.

- Evaluating and balancing the clinical, capital and IT resources required to accelerate health information technology programs and potentially reducing resources and costs in other areas.

- Monitoring the requirements around showing meaningful use of a certified electronic health record product.

Proactive consideration of these practices will assist institutions in complying with the new requirements of the Recovery Act while taking advantage of the additional resources available from granting agencies.

Enterprise Risk Management

►Background

Now more than ever, organizations of all types and sizes are dealing with significant risk on a day-to-day basis. Risk is any issue that impacts an organization's ability to meet its strategic objectives. Risk can generally be categorized in the following five broad categories:

- Strategic - high-level goals, aligned with and supporting the institution's mission;
- Operational - effective and efficient use of the institution's resources;
- Reporting - reliability of the institution's external and internal reporting;
- Compliance - the institution's compliance with applicable laws and regulations; and
- Reputational - damage caused by any of the other four that spills over to how the institution is valued or perceived.

The degree to which each of these types of risks exists within an organization is dependent to a certain extent upon the size and complexity of the organization. All entities face risk; the challenge for management is to determine how much and what types of risk are acceptable when setting its strategic goals.

Enterprise Risk Management ("ERM") philosophies have been embedded in corporate culture for a number of years. The Committee of Sponsoring Organizations of the Treadway Commission ("COSO") defines ERM as "…a process, effected by an entity's Board of Directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, and to provide reasonable assurance regarding the achievement of entity objectives." ERM recognizes that risks cannot be avoided, but the vast majority of surprises can be minimized. ERM also embodies a mindset that the risk population of an entity is too broad and too deep to be fully understood and managed from the senior management leadership suite.

► Impact on Educational Institutions

Many Board members of educational institutions that have been part of implementing ERM initiatives in the corporate environment are asking the following questions:

- Does the institution have a risk assessment methodology in place?
- Does it understand the key risks and what is being done about them?
- Is an ERM structure viable?
- How can the institution implement ERM and where does it start?
- How can an ERM infrastructure be sustained?

Many research universities with academic medical centers have compliance programs in place that embody many of the same principles of ERM and have begun to broaden those programs to address risk beyond compliance. In fact, some universities have begun to adopt ERM programs. Other universities have risk assessment methodologies in place in certain areas but they are not formalized nor do they include all types of risk that exist across the entire enterprise. For those universities that have less formal risk assessment programs in place, ERM can serve as an excellent platform from which to formalize and enhance already existing programs.

A current key challenge for universities is how best to adopt the provisions of ERM in a highly decentralized environment and at a time when most universities are resource and priority constrained.

►PwC Perspective

Within a college or university, it is more critical than ever before to understand the risk profile of an institution. ERM is not about eliminating risk; it is about understanding where risks are, what existing controls are in place to mitigate them, and what additional controls can or should be put in place to bring the risk to a more tolerable level. It is important to first have an understanding of the risk appetite of the university from both management and the Board's perspective.

The most successful ERM implementations involve the entire university, and cannot involve senior-level management only. Everyone has a role, and those roles should be clearly defined.

The Board, primarily through the role of the Audit Committee, is ultimately responsible for ensuring that ERM initiatives are being adhered to and carried out as appropriate. The Board should be monitoring to ensure the focus of ERM shifts as overall operational strategies change throughout an institution. Typically the Chief Financial Officer or Chief Risk Officer, or in certain cases the Office of General Counsel operationally owns the ERM process. It is important for whoever owns the process to ensure the appropriate people are involved across the institution. The most successful implementations include management representatives from every major department across campus. Many universities have established "Risk Steering Committees." Such committees are made up of a cross section of university management that coordinates the risk assessment, prioritization, and risk mitigation process across the institution. These committees have been successful setting the ERM strategy and agenda.

Internal audit departments have historically driven ERM initiatives in higher education. They have an important role—adding value to the ERM initiatives by giving their sense of the overall risk issues facing the institution, keeping the risk agenda on task, and ensuring that management takes responsibility for the ERM initiative and risk mitigation strategies.

Institutions should also consider how the ERM program will be monitored. Important questions include identifying who will be responsible for which mitigation strategies are implemented, and whether the strategies are operating effectively.

At the outset of the project, ERM can be very overwhelming. Certainly as one looks across an entire institution, there are multiple risks. It is important to start by assessing and prioritizing risk at some level in the institution. It is also helpful to focus on one category of risk at a time and to have a response plan or framework in place. For example, once an institution has identified all of the particular risks, a plan should be in place to determine which risks will be focused on first and mitigated, which will be monitored, and which will be left as is. The response plan will help to keep an appropriate focus on those key risks which are most significant to the organization's ability to continue its strategic mission and meet its strategic goals.

It is also important to recognize that ERM is a continual and evolving process. In order for it to be successful, it has to be embedded in the overall institutional strategy and management philosophy of the institution, so that as new initiatives or strategies are proposed, risks are identified and dealt with appropriately within the context of an ERM framework, and complement strategic initiatives.

Tuition Affordability

►Background

Tuition affordability remains a concern of students, parents, regulators, and other constituent groups. The price of attending college for a year is commonly compared to annual income, and as family income declines, paying for a college education is becoming a greater challenge. Although information released by the College Board in 2008 shows that over a working life, the typical full-time worker with a four-year college degree earns over 60% more than a worker with only a high school diploma[i], attaining this degree is becoming increasingly unaffordable for many families.

Although tuition increases this year are less than in prior years, paying for these increases is challenging for families. While time is needed to assess the complete economic impact on higher education and tuition affordability, families looking to cut costs and save money will likely be seeking more financial aid than ever before. Compounding the ability of families and students to pay for a college education, by October 2008, approximately two dozen lenders had stopped issuing or cut back on student loans.[ii]

► Impact on Educational Institutions

As institutions respond to the challenges that families are facing, several additional current factors that can impact tuition affordability include:

- Impact of additional funding for financial aid from the American Recovery and Reinvestment Act;
- Revised institutional endowment payout strategies in support of financial aid; and
- Accessibility of tuition financing and the availability of student loan lenders.

The American Recovery and Reinvestment Act will provide approximately $30 billion in new funding in 2009 and 2010, coming in the form of a $17 billion increase in Pell Grants and $13 billion in more higher education tax credits. Institutions are factoring in these forms of financial assistance when considering future awarding strategies.

Many institutions are determining how to fund financial aid-related endowments that may be underwater as a result of market conditions. From a strategic perspective, institutions are deeming the funding of these initiatives to be critical to maintaining affordable tuition for those who can not cover the full cost of education. Universities continue to work to maintain or increase their budgets for financial aid. For example:

- Institutional awards increased 8% in 2007-08 from the prior school year;[iii]
- Institutions have become the largest source of grant aid, accounting for 42% of all grants;[iii]
- Over 80% of entering first-time, full-time undergraduates receive an institutional grant award;[iii]
- 75% of private colleges have experienced increasing requests for institutional aid;[iii] and
- While only 11% of these institutions drew more funds from their endowments to accommodate these requests, an additional 17% were able to cut other areas of their budgets and shift funds to financial aid.[iii]

In addition, institution's often utilize the Federal Family Education Loan Program (FFELP), through which banks make federal student loans backed by the federal government. In 2008, when available capital from this program came into question and the private loan market became volatile, many institutions began to turn to the Federal Direct Student Loan program, which provides funds directly from the federal government rather than banks or other lenders. This was a move that many institutions felt would secure students' continued education. These Direct Loans currently account for about 30% of all federal student loans and may account for over half by late 2009.

►PwC Perspective

The trends in institutional aid imply that colleges and universities continue to be challenged to contain costs and commit financial aid to students of need. More than ever, as students and their families struggle through difficult economic times, university officials need to be vigilant in providing the most timely and thoughtful information to students, parents, donors, and Board members. Actions taken should foster discussion, specifically around the following:

- How tuition increases are established and their relationship to institutional costs;
- The willingness of the institution to provide grants and loans to students;
- The determination of endowment payout rates and the percentage of endowment payout that supports financial aid; and
- Strategies employed to raise endowment funds in support of need-based scholarships.

Universities should continue to be as transparent as possible, by explaining how the economy is affecting their own operations, what costs are necessary to support and manage the institution, and the investments that are required to support long-term institutional strategies—all while remaining focused on delivering the important message regarding the social, economic and other benefits that an education provides.

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[i] Source: College Board publication, What Every Parent Should Know about Paying for College, from 2008 Trends in Higher Education Series.

[ii] Source: TIME news article, Colleges Getting Hit by the Credit Crunch, dated October 8, 2008.

[iii] Source: NACUBO and AGB publication, The Financial Downturn and Its Impact on Higher Education Institutions, dated October 24, 2008.

Green Initiatives

►Background

Green initiatives are increasingly becoming a key question of prospective and current students as they evaluate educational institutions. Measures of accountability are becoming standardized across the U.S. and are providing students with access to information, which increases their expectations of higher education institutions. The most recent annual survey conducted by the Princeton Review of "College Hopes and Worries (2009)" showed that 64% of participants in the survey would value having information about a college's commitment to the environment. Among the participants, 24% said such information would strongly or very much impact their or their child's decision to apply to or to attend the school.[i] In response to these expectations, such organizations as the Princeton Review and Kaplan have added "green ratings" to their evaluations of educational institutions in the U.S. These ratings have been established based upon the institution's practices, policies and course offerings. As comparable information becomes more readily available to prospective students and becomes more standardized across the U.S., colleges and universities are going to be held to an increasingly higher standard for leadership in the green movement.

Colleges and universities across the country are developing policies to formalize the green initiatives on campus. Many educational institutions have utilized the LEED ("Leadership in Energy and Environmental Design") metrics established by the United States Green Building Council ("USGBC") as a framework for developing institutional policies. For example, of the 39 institutions highlighted by the USGBC for their leadership in green building, 41% of the institutions required all new buildings to attain at least the silver level of LEED certification.[ii] According to the American Council on Education, 133 colleges and universities have built LEED certified buildings and the National Association of Independent Colleges and Universities ("NAICU") has reported that the number of campus projects registered for LEED certification has grown an average of 37% per year since 2002.[iii] Adopting institutional policies of sustainable building standards has provided colleges and universities with a benchmark for publically reporting and evaluating their relative involvement.

Green building is only one way educational institutions can become involved in sustainable practices. Other areas of participation include maximizing water and energy efficiency, reducing carbon emissions, planting native landscapes and incorporating awareness and education into the curriculum. Educational institutions are uniquely positioned to be leaders in the efforts to educate the next generation on environmental concerns and best practices. Over 600 college and university presidents have pledged their commitment to the American College and University Presidents Climate Commitment to be leaders in the community by modeling ways to eliminate global warming emissions and by providing the knowledge and the educated graduates to achieve climate neutrality.[iv] Additionally, the College Sustainability Report Card, the only independent evaluation of campus and endowment sustainability, noted significant improvements across a wide array of areas of sustainable practices in terms of the aggressiveness of the programs and the number of educational institutions with programs.[v] However, while these initiatives are gaining momentum in educational institutions across the country, there are minimal controls in place to validate the information being voluntarily reported by the institutions and additional benchmarks for comparisons are needed.

► Impact on Educational Institutions

Given the current financial pressures faced by most institutions, it is difficult to consider new initiatives, particularly those with significant upfront costs. The ability of educational institutions to enact policies and incorporate change in operations can depend on the size of the organization, the size of the population the organization serves and its overall financial means. However, there are many different ways to incorporate green initiatives on campus. Some large colleges and universities have been able to assemble sustainability committees of faculty members and have hired sustainability coordinators, while some smaller organizations with fewer financial resources have been able to bring about change through volunteer and student-run initiatives. The College Sustainability Report Card, published by the Sustainable Endowments Institute, found that the most prevalent area of involvement of educational institutions is in food and recycling, which can be a largely student-run initiative.

Other ways that educational institutions are making change possible, despite financial constraints, include grants and rebates. President Obama has continually stated his commitment to address climate change and energy consumption. Through the American Recovery and Reinvestment Act, tax credits and grant funding are available for research in sustainable projects. Additionally, utility rebates can be a way of reducing overall costs of conservation programs. Given the constraints of educational budgets, it is important for educational institutions to consider incentive programs currently being offered to entice organizations to be involved in the green movement.

► PwC Perspective

Educational institutions' ability to integrate green initiatives successfully into the culture of the organization is increasingly being viewed as a strategic, compliance, operational, reputational and financial issue. Currently, voluntary reporting is the only source of information for interested stakeholders, including prospective and current students, parents, faculty, donors and local communities. Benchmarks and increased monitoring controls are needed to evaluate the impact the programs are truly having on the environment. In the interim, educational institutions should continue to develop strategies to inform the public of the ongoing efforts of the institution by participating in voluntary reporting mechanisms and work to balance the rising expectations of the current students and the students of the future with the demands of the university's infrastructure, operational and budgetary commitments.

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[i] Source: Princeton Review 2009 Survey, College Hopes & Worries Survey.

[ii] Source: U.S. Green Building Council website.

[iii] Source: National Association of Independent Colleges and Universities website.

[iv] Source: American College & University President's Climate Commitment website.

[v] Source: The College Sustainability Report Card.org.

Identity Theft

►Background

Identity theft is the number one complaint to the Federal Trade Commission ("FTC"), impacting 4.6% of U.S. citizens each year with an estimated $50+ billion in losses. In just the first 3 months of 2009, the Identity Theft Resource Center ("ITRC") reported 133 data breaches nationwide, that potentially exposed 1.5 million records containing personally identifiable information (also referred to as "PII"), such as Social Security and credit card numbers. Of those breaches, 14.3% represented data breaches at higher education institutions. According to the ITRC, a non-profit organization that works to promote the understanding and prevention of identity theft, approximately 650 data security breaches at higher education institutions had been reported by the end of 2008, which reflected an increase of 47% over the prior year.

Universities collect and maintain large amounts of data from current students, former students, students not accepted by the institution, alumni and their families, faculty, employees and research subjects. This large amount of data makes higher education institutions targets of data breaches. Recently, a data breach into a university network led to the theft of information of 40,000 elderly residents based on a hosting arrangement between the University and an Office on Aging.

PII is a commodity in and of itself. On the black market, university-related PII is extremely valuable. In a May 2008 report published by the Malicious Code Research Center, the fees for providing stolen personal information can be lucrative. Typically, a stolen name and Social Security number can be sold for approximately $10; adding information such as a home address and date of birth could increase the asking price to $16-$17 each. Multiplied by thousands of names, identity theft has become a big business.

In addition to the personally identifiable information students provide at time of enrollment, campus health services centers also collect and maintain health insurance information and other medical information, such as immunization records and names of the physicians that students may have seen for diagnoses or treatment. In 2009 a health-information data breach exposed not only students' information but also their parents and spouses who were linked to the insurance coverage. Medical identity theft itself is a $1 billion dollar business expected to grow exponentially in the coming years. Today, the value of a single health record can bring $50 to $60 on the black market. In 2005, an estimated 250,000 Americans were victims of medical identity theft, a 334% increase over 2001.

Recognizing the growing epidemic of identity theft, the FTC enacted the Identity Theft Red Flags Rule effective November 1, 2008. The anticipated enforcement date is November 1, 2009. The Red Flags Rule was designed specifically to reduce, prevent and mitigate the risk of identity theft. Institutions covered by the Rule are those that collect and use confidential consumer data and maintain account relationships that have regular account-related transactions. These include banks, creditors, certain healthcare services providers, as well as many colleges and universities. For example, if an institution participates in the Federal Perkins Loan program, is a school lender in the Federal Family Education Loan Program, or offers loans to students, faculty or staff, the institution could be considered a “creditor” under the Red Flags Rule.

The Red Flags Rule differs from other data protection / identity theft prevention requirements in that its focus is the use of fraudulently acquired data to obtain credit or other credit related services. Due in large part to their clean credit records upon entering college, students are often targets of identity thieves, as newly enrolled college students are prime targets of credit card issuers and other companies. Additionally, the Red Flags Rule places affirmative duties on financial institutions and certain creditors, such as higher education institutions, to focus on the "reasonably foreseeable risk to the safety and soundness" of the institution towards detecting, preventing and mitigating potential institutional risks posed by identity theft.

►Impact on Educational Institutions

Organizations required to comply with the Identity Theft Red Flags Rule will need to develop and implement a written identity theft prevention program. Under the Rule, covered organizations are required to conduct a targeted risk assessment based on specified criteria to identify certain classes of accounts and account-related activities that potentially may pose a risk of identity theft. Rather than viewing the Rule as requiring large expenditures in technology and people, universities should look to leverage existing processes that help to enhance data security and fraud reporting. Universities should consider that the risk of non-compliance may result in reputational and brand damage; potential loss of revenue; civil liability arising out of identity theft-related damages to current and former students, their families, and university employees; as well as the potential of significant regulatory penalties for failing to protect confidential data.

As a result of this new law and increased risk of identity theft and data breaches, higher education institutions are increasingly assessing risk. Many are adopting approaches to information security similar to those used by private industry companies, such as putting enhanced administrative, technical and physical security controls in place for the protection and sharing of information. Some of those safeguards include: limiting (i) access and use of admissions and matriculatation information, (ii) the ability to conduct global research and operations, and (iii) sharing of research data and results. Key initiatives include:

- Developing integrated frameworks that combine compliance, privacy, security and identity theft
- Inventorying and removing sensitive data from business and HR processes
- Enhancing administrative safeguards such as:
  - Integrated privacy and information risk management assessments
  - Incident response plans to cover privacy
  - Training
  - Employee background checks
  - Contractual safeguards with third parties that handle confidential information
  - Vendor assessments
- Reviewing and enhancing or implementing key identity theft safeguards such as:
  - Encryption of data in storage and transit
  - Access controls and identity management
  - Document retention compliance
  - Data leakage prevention
  - Use of alternative identifiers and social security numbers/other sensitive information masking

►PwC Perspective

Identity theft is an issue of concern to regulators and consumers, including students and their families, faculty and employees. Colleges and universities will need to determine the extent to which the Identity Theft Red Flags Rule applies to their operations. As many institutions seek to attract students and donors and maintain relevance in the age of technology, they have turned to tactics used by marketers over the years. In doing so, higher education institutions now fall under the watchful eye of regulators such as the FTC. To that end, protecting the information assets of the institution and complying with the growing specter of regulatory requirements are more important than ever. Higher education has often approached risk and compliance on a law-by-law basis and/or in vertical silos across the organization. To promote consistency, heighten compliance and potentially generate efficiencies and cost savings, colleges and universities have been developing integrated frameworks and new governance models and managing common controls across multiple laws, risks and parts of the institution. Additionally, colleges and universities that take affirmative steps to address identity theft and data mismanagement prevention often experience a marked reduction in the number of incidents of breaches and data mismanagement.

Electronic and interactive communications have added and accelerated the frequency and amount of information sharing at higher education institutions. Moreover, as students, education, research, collaboration, fundraising, campus satellites and other key future growth and strategic initiatives increasingly expand globally, the success of many of these initiatives relies on the ability to share information freely cross-border to non-U.S. locations. Further, with an increasing number of applicants, students, alumni, researchers, faculty and partners, educational institutions should assume greater stewardship of the personal data they are collecting. While the issue of privacy protection and identity theft prevention among institutions of higher learning is focused on heightened controls and data security, it will be the responsible handling of personal information that will enable institutions to use such information to achieve critical educational, research, development and community-related goals.

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