Higher Ed & Not-for-Profits: Economic uncertainty and financial reporting

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It’s not business as usual: Economic uncertainty and financial reporting

Continuing economic uncertainty — rising interest rates, inflation, recession fears — means that reporting season is not business as usual.

The aftereffects of the global pandemic and the ongoing geopolitical unrest are reverberating throughout the economy, changing consumers’ spending habits and disrupting the supply chain.

The current economic environment makes accounting estimates and forecasting cash flows even more difficult than they already are.

Preparers should be mindful of having the right resources lined up to address this year’s reporting challenges. The current economic trends are likely to make accounting judgments more complicated and may require more resources than the financial reporting function has needed in the past.

These concerns cut across industry and geography, regardless of entity size. Additional attention should be particularly focused on accounting areas requiring significant judgment and related disclosures.

“Rising costs, talent shortages, demands for greater efficiency and transparency, muted investment returns and their impact on future endowment spending, combined with less favorable credit markets and cybersecurity concerns, are just a few of the risks financial executives in the education and not-for-profit sectors must consider in meeting financial and other reporting requirements,” said KPMG Audit Partner **David Gagnon,** National Industry Leader, Higher Education & Other Not-for-Profits.

These pressures are occurring just as competition for revenue from students, donors, and grantors is accelerating and as the possibility of a global recession looms. In the wake of these rapidly changing conditions, senior administrators at colleges, universities, and other not-for-profits (NFPs) should reevaluate enterprise risks.

They should consider how the changing economic environment may impact financial reporting and compliance. For example:

- Given recent attrition, is staffing in key financial, accounting, technology, and compliance roles sufficient to meet financial statement and tax and other regulatory reporting requirements and deadlines? Have fraud risks been elevated by changes in personnel or business processes, and how are such risks being mitigated?
- As technology advances, have policies, internal controls, and personnel skill sets been re-aligned to ensure timely, complete, and accurate system reports for budgeting, compliance with grantor and donor agreements, and financial statement preparation? Are data privacy and protection protocols appropriate?

— Do management's most sensitive judgments and estimates in the financial statements – such as those used to establish allowances for doubtful accounts and pledges receivable, as well as assumptions used in benefit plan measurements – reflect changing market and other factors in the NFP's environment?

— Have higher costs, revenue constraints, or the related use of or decline in expendable net assets been properly considered in projecting and monitoring financial debt covenants? How may financial statement disclosures regarding liquidity and availability of resources be affected?

For institutions with federal student aid funding, impacts on U.S. Department of Education Financial Responsibility Standards may also be relevant. In addition, management's requirement to assess (at least annually) the entity's ability to continue as a going concern under ASC 205-40 should embed adverse conditions or events, as appropriate, and may be helpful to understanding financial impacts on the organization more broadly.

Regardless of the industry, preparers should ask:

- whether management's projections are consistent with expectations in the current environment;
- how their business has been impacted by inflation;
- whether there are other financial challenges their customers may be facing, and the possible impacts on demand; and
- how the rising interest rate environment impacts discount rates used in accounting estimates.

Preparers should be mindful that this year-end reporting season is not 'business as usual'. Challenges posed by the current economic environment may require additional attention and judgment.

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