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Universities accounting for themselves

This paper briefly describes the distinctive features of the Transparent Approach to Costing (TRAC) and disputes its value as a guide to financial sustainability. In particular I discuss the Return on Financing and investment (RFI) adjustment which helps to turn accounting surpluses into TRAC deficits. The Higher Education Funding Council for England (HEFCE) which "monitors that universities and colleges [in England] are financially healthy" believes that the TRAC adjusted deficits are "arguably a more reliable guide to an institution's medium-term financial sustainability". The paper adduces arguments as to why the TRAC adjusted figures do not work as any indicator of financial sustainability. This approach is independent of the 'Garbage in, garbage out' argument which notes that the TRAC process relies on the much-questioned (and much adjusted) inputs of the academic time survey. The argument presented here suggests that, even if the inputs from the academic time survey were as good as was needed, the TRAC methodology and the specific TRAC adjustments generate the 'wrong' answers to the questions of medium term financial sustainability.

The methodological approach in the paper is also interesting because it does not [and cannot] rely on the default approach of 'evidence based justification' because HEFCE refuse to release the data for individual universities so it is not possible to compare individual institutions. This forces us to revert to the analytical approach of building models of medium term financial sustainability and trying to understand whether the TRAC adjustments illuminate the analysis or, as I argue, are dangerously misleading. The focus of criticism of the TRAC methodology has so far been weighted towards the quality of the 'evidence base' of the academic time survey and has neglected the fact that even were these ‘perfect’ inputs, the TRAC methodology generates false conclusions about financial sustainability.

The paper deals with several related issues concerning the TRAC adjustments.

1 The argument explores simple financial models of the average university and separates out the effects of financing of capitalised investments from i) accumulated surplus ii) gifts – or deferred capital grants and iii) borrowings. The three scenarios are considered for their medium term financial sustainability and impact of the TRAC RFI adjustments are calculated and analysed. The use of the TRAC methodology gives the ‘wrong’ answer both when used to compare similar universities which differ only in their financing activities and when used to compare financing options within a university. Any university following the path of generating the smallest TRAC deficits will make worse decisions with respect to medium term financial sustainability. The conclusion is that the use of TRAC across and within universities gives the wrong results – it leads to decisions which are less financially sustainable in the medium term.

2 The simple financial models and the chosen scenarios make it seem too obvious that the TRAC methodology is flawed and raise the question of why this has not been pointed out before. This may lead to a questioning of the simplicity of the models developed and presented in the paper with respect to the complexity of the financial features of any existing, individual university or that the scenarios are not fully described to capture all the relevant features. The search for a fundamental flaw then leads us to note that the TRAC methodology is not part of the accounting system but simply mimics some of its forms. The TRAC adjustments are one-legged entries – they are ‘dangling debits’ with no corresponding credits in the balance sheet.

Abraham Lincoln is reported to have asked:

‘How many legs does a dog have if we call the tail a leg?’

His answer was ‘Four’ because calling a tail a leg does not make it a leg. Likewise with TRAC, the RFI adjustment is not part of an accounting double entry system so subtracting it from an accounting surplus does not make that surplus into a deficit even if we call it a costing adjustment. TRAC is not part of any ‘accounting’ system which is, at core, a double entry book keeping system.

3 The TRAC methodology led to recurring deficits when funding to universities was increasing and will continue to show deficits while funding to universities decreases. The TRAC methodology will soon be shown to be largely insensitive to substantial changes in the funding environment and this may provoke a reappraisal. If the TRAC accounting adjustments were then adapted to be part of the double entry system, there would be credits in the balance sheet. We would then need criteria as to when the TRAC ‘credit balances’ would be released as Income to boost the surpluses in future years. In the current TRAC methodology this ‘never’ happens so any ‘notional’ setting aside for long term financial sustainability never receives an offsetting credit at the point of investment and the deficit persists or – yet more misleading - a further TRAC adjustment is also calculated at the point of later investment.

4 The further development of the TRAC methodology to cover these defects does not seem worthwhile because University balance sheets already include Deferred Grant Income balances which seem to function in ways that duplicate some of the adjustments that the TRAC methodology aims to provide.

5 If the TRAC methodology had been successful in providing indicators of medium term financial sustainability through use of the RFI adjustment then one would have expected

this to be adopted by the commercial sectors where medium term *financial* sustainability is the key issue for those organisations.

6 TRAC and any other Surplus derived performance measures are not appropriate for Universities because they are not institutions which should be profit/surplus maximisers – they are charities with particular missions to achieve and it is possible for Universities to generate ‘too much’ surplus which is rarely true of commercial enterprises.

7 The only justification for TRAC’s continued use is if it were effective in leveraging funding from government for the Universities. This raises as many moral questions as it answers.