Grant Thornton

2018 Audit Wrap-up Presentation and Discussion

Nevada System of Higher Education

Our Values are CLEARR

To achieve our global vision, we capitalize on our strengths by embracing the following values:

- Unite through global Collaboration
- Demonstrate Leadership in all we do
- Promote a consistent culture of Excellence
- Act with Agility
- Ensure deep Respect for people
- Take Responsibility for our actions

Our values serve as the foundation of each step we take toward achieving our vision. They guide our decision-making and provide a framework for our people to make correct and appropriate choices.

Our Responsibilities

We are responsible for:

- Performing an audit under US GAAS and Government Auditing Standards of the financial statements prepared by management, with your oversight
- Forming and expressing an opinion about whether the financial statements are presented fairly, in all material respects in accordance with US GAAP
- Forming and expressing an opinion about whether certain supplementary information, including the Schedule of Expenditures of Federal Awards (SEFA) is fairly stated in relation to the financial statements as a whole.
- Communicating fraud and abuse with regard to federal and state programs
- Communicating specific matters to you on a timely basis.
- Reading other information and considering whether it is materially inconsistent with the financial statements
- Reporting material non-compliance related to laws, regulations, contracts and grant agreements, as well as significant deficiencies and/or material weaknesses in internal control related to financial reporting
- An audit provides reasonable, not absolute, assurance that the financial statements do not contain material misstatements due to fraud or error. It does not relieve you or management of your responsibilities. Our respective responsibilities are described further in our engagement letter.

Those Charged With Governance and Management Responsibilities

Those Charged with Governance are responsible for:

- Overseeing the financial reporting process
- Setting a positive tone at the top and challenging the System's activities in the financial arena
- Discussing significant accounting and internal control matters with management
- Informing us about fraud or suspected fraud, including its views about fraud risks
- Informing us about other matters that are relevant to our audit, such as:
  - Objectives and strategies and related business risks that may result in material misstatement
  - Matters warranting particular audit attention
  - Significant communications with regulators
  - Matters related to the effectiveness of internal control and your oversight responsibilities
  - Your views regarding our current communications and your actions regarding previous communications

Management is responsible for:

- Preparing and fairly presenting the financial statements including supplementary information such as SEFA (Schedule of Expenditures of Federal Awards) in accordance with US GAAP
- Designing, implementing, evaluating, and maintaining effective internal control over financial reporting
- Communicating significant accounting and internal control matters to those charged with governance
- Providing us with unrestricted access to all persons and all information relevant to our audit
- Informing us about fraud, illegal acts, significant deficiencies, and material weaknesses
- Adjusting the financial statements, including disclosures, to correct material misstatements
- Informing us of subsequent events
- Providing us with written representations

Materiality

Essentially, Materiality is the magnitude of an omission or misstatement that likely influences a reasonable person's judgment. It is based on a relevant financial statement benchmark.

- We believe that total assets is the appropriate benchmark for the System and System-Related Organizations

Financial statement items greater than materiality are within our audit scope. Other areas less than materiality may be in our scope if qualitative risk factors are present (for example, related party relationships or transactions and fraud risk).

Audit Timeline & Scope

March 2018	Client reacceptance	• Client reacceptance • Issue engagement letter • Conduct internal client service planning meeting, including coordination with IT audit support team
April-July 2018	Planning	• Meet with management to confirm expectations and discuss business risks, coordinate planning and develop work calendar • Discuss scope of work and timetable • Identify current-year audit issues and discuss recently issued accounting pronouncements of relevance
May 2018	Preliminary risk assessment procedures	• Develop audit plan that addresses risk areas • Update understanding of internal control environment
May-September 2018	Interim fieldwork	• Perform walk-throughs of business processes and controls
September-November 2018	Final fieldwork and deliverables	• Perform final phase of audit and year-end fieldwork procedures • Meet with management to discuss results • Present results to the Audit Committee

Significant risks and other areas of focus

The following provides an overview of the areas of significant audit focus based on our risk assessments.

Significant risk	Results
Tuition revenue and related receivables/deferred revenue	• Obtained the rates in effect for the year under audit and used this information to set expectations of revenue for tuition and fees. Performed detailed tuition reasonableness test based on this information. • Obtained an understanding of the semester and billing schedules. Performed substantive testing on receivables and deferred amounts to ensure proper cutoff. • Reviewed management's analysis of allowance for doubtful accounts for consistency with methodology and accuracy of inputs. • Performed detailed testing of PeopleSoft Student Account revenue by selecting a random sample, then testing verified charges and receipt of payment to revenue recorded.

Significant risks and other areas of focus- continued

The following provides an overview of the areas of significant audit focus based on our risk assessments.

Area of focus	Results
Federal, State, local and other grant revenue and related receivables/deferrals	• Performed detailed testing of grant revenue by selecting a random sample and testing grant contract, request for reimbursement, receipt of payment and reasonableness of expenses to revenue recorded. • Selected a random sample of grant revenue receivable and tested balance to ensure appropriately recorded.
Sales and Service Revenue	• Performed detailed testing of sales and services revenues by selecting a random sample and testing verified charges, and receipt of payment to revenue recorded. • Preformed analytical review and substantive testing on receivables and deferred amounts to ensure proper cutoff.

Significant risks and other areas of focus- continued

The following provides an overview of the areas of significant audit focus based on our risk assessments.

Area of focus	Procedures
Net pension liability, including related deferred inflows and outflows of resources; and net other post-employment benefits liability, including related deferred inflows and outflows of resources.	• Obtained PERS and PEBP audit reports, performed testing of completeness and accuracy of data submitted to PERS and PEBP, performed testing of reasonableness of actuarial assumptions and reviewed reasonableness of accounting entries and financial statement disclosures including the adoption of GASB 75 "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions."
Fair value measurement of investments priced with models or similar techniques	• Gained an understanding of management's process for valuation • Tested management's fair value estimates, confirmed balances, and tested balance to ensure all investments have been appropriately recorded.
Fair value of financial instruments (alternative investments)	• Tested documentation over process to value alternative investments and traced to supporting documentation, including audited financial statements of the respective alternative investment funds.

Significant risks and other areas of focus- continued

The following provides an overview of the areas of significant audit focus based on our risk assessments.

Area of focus	Procedures
Financial reporting and disclosures	• Reviewed financial statements and related disclosures for accuracy and completeness. • Traced amounts to supporting documentation. • Reviewed documentation regarding implementation of newly effective GASB pronouncements and determined reasonableness of presentation.
Management override of internal controls	• Identified where fraud could occur and extracted specific entries for testing. • Tested that appropriate internal controls are in place in accordance with their purpose

Technology support as part of the audit process

Understand and document business processes material to the audit

Phase 1

Assess IT risks

Phase 2

Identify IT controls that support audit objectives

Phase 3

Test technology-related controls

Phase 4

An important component of our audit approach is to understand how IT is used in supporting business operations and producing financial reports. Our technology specialists place particular emphasis on the risks relating to the use of technology and its associated controls, processes and practices.

Our general controls review evaluates the design of controls that mitigate risk in areas such as organization and operations, protection of physical assets, application systems development and maintenance, access controls and computer operations.

System Summary of Misstatements ($000s)

Description	Assets	Liabilities	Net Assets	Net Income
Corrected misstatements				
None noted				
Net impact	$ -	$ -	$ -	$ -
Uncorrected misstatements				
1 To pass on the reversing effect of not implementing GASB 82 in the prior year.			(23,555)	(23,555)
2 To pass on adjusting cash held with the State to actual.	2,145 (2,145)			
Net impact	$ -	$ -	$ (23,555)	$ (23,555)

Management believes the uncorrected misstatements are immaterial to the financial statements. Uncorrected misstatements could be potentially material to future financial statements.

System Related Organizations Summary of Misstatements ($000s)

Description	Increase (Decrease) to: Assets	Liabilities	Net Assets	Net Income
Corrected misstatements				
UNLV Foundation				
1 To adjust Restricted Net Position-Nonexpendable			(42,195)	
and Expendable, and Unrestricted Net Position			40,580	
in accordance with GASB 54.			1615	
2 To adjust Endowment Pledges Receivable in	(8,107)	(8,107)		
accordance with GASB 33.				
Net impact	$ (8,107)	$ (8,107)	$ -	$ -

System Related Organizations Summary of Misstatements ($000s)

Description	Assets	Liabilities	Net Assets	Net Income
	Increase (Decrease) to:			
Uncorrected misstatements				
UNLV Foundation				
1 To pass on recording the reversing effect of error in opening net position			(679)	679
UNLV Medicine				
2 To pass on reclassifying related party accounts receivable (included as contracts receivable) related to Federal grants and contracts with UNLV and NSHE from $275,000	275	275		
UNR Foundation				
1 To pass on recording prior year impact due to implementation of GASB 81 and split-interest agreement being stated at NPV in the prior year		(320) 320		
Net impact	$ 275	$ 275	$ (679)	$ 679

Management believes the uncorrected misstatements are immaterial to the financial statements.

Other Required Communications

Professional standards require that we communicate the following matters to you, as applicable.

Going concern matters – None Noted
Fraud and noncompliance with laws and regulations – None Noted
Significant deficiencies and material weaknesses in internal control over financial reporting – See separate communication significant deficiencies
Use of other auditors – None Noted
Use of internal audit – Not applicable to the financial statement audit
Related parties and related party transactions - No previously undisclosed related party transactions were encountered.

Other Required Communications
(continued)

Disagreements with management - We had no disagreements with management.
Management's consultations with other accountants - We are not aware of any consultations by management with other accountants regarding accounting or auditing matters.
Significant issues discussed with management – Significant matters discussed included the conversion to Workday and the adoption of GASB 75 Accounting and Financial Reporting for Postemployment Benefits Other than Pensions
Significant difficulties encountered during the audit – aside from delays in the year end close and financial statement preparation which stemmed from the Workday conversion, no significant difficulties were encountered
Other significant findings or issues that are relevant to you and your oversight responsibilities – None noted
Modifications to the auditor's report – None noted
Other information in documents containing audited financial statements - Upon reading the other information, we did not identify any material inconsistencies or material misstatements of fact.

Quality of Accounting Practices

Accounting policies	Accounting policies are disclosed in Note 2 of the financial statements, and appear consistent and appropriate.
Accounting estimates	Significant accounting estimates include the fair value of alternative investments, and the net pension and OPEB liabilities. Management has informed us that in determining the appropriateness of these fair value determinations, they evaluated all significant information from investment fund managers, including audited financial statements for all funds invested in, as well as all significant information from the actuarial reports and allocation schedules for the net pension and OPEB liabilities.
Disclosures	Financial statement and related disclosures appear to be clear and complete. Disclosures are presented with overall neutrality, consistency and clarity.

Deliverables

- Report on the financial statements of Nevada System Of Higher Education (the "System") for the year ended June 30, 2018
- Report on Internal Control Over Financial Reporting and On Compliance and Other Matters Required by Government Auditing Standards for the year ended June 30, 2018
- Schedule of Findings and Questioned Costs
- Provide timely and appropriate communication with management and the Audit Committee regarding technical audit, accounting and internal control matters.

Internal Controls Matters

Responsibility

We are responsible for obtaining reasonable assurance about whether the financial statements are free of material misstatement. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we express no such opinion. Control deficiencies that are of a lesser magnitude than a significant deficiency will be communicated to management.

Definitions

- A deficiency in internal control ("control deficiency") exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect, misstatements on a timely basis.
- A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the system's financial statements will not be prevented or detected and corrected on a timely basis. Internal control deficiencies associated with the System's financial statements that we consider to be significant deficiencies are summarized in the Schedule of Findings and Questioned Costs

Use of Other Auditors

Component	Auditors	Benchmark*	Response**
Grant Thornton International Ltd member firms			
University of Nevada, Reno Foundation	Grant Thornton	42%, 19%	Comprehensive
Athletic Association, University of Nevada, Inc.	Grant Thornton	1%, 0.1%	Comprehensive
Integrated Clinical Services, Inc.	Grant Thornton	1%, 8%	Comprehensive
University of Nevada, Las Vegas Foundation	Grant Thornton	46%, 29%	Comprehensive
University of Nevada, Las Vegas Medicine	Grant Thornton	3%, 37%	Comprehensive
Other			
UNLV Rebel Football Foundation	Other	0%, 0.1%	Analytical
UNLV Rebel Soccer Foundation	Other	0%, 0.5%	Analytical
UNLV Singapore	Other	1%, 0%	Analytical
GBC Foundation	Other	1%, 0.5%	Analytical
Other unaffiliated auditors			
WNC Foundation	Other	0%, 1%	Analytical
Rebel Golf Foundation	Other	1%, 0.4%	Analytical
UNLV Alumni Association	Other	0%, 0.9%	Analytical
UNLV Research Foundation	Other	1%, 0.2%	Analytical
DRI Foundation	Other	0%, 0.8%	Analytical
DRI Research Park	Other	0%, 0%	Analytical
TMCC Foundation	Other	1%, 0.7%	Targeted
CSN Foundation	Other	1%, 0.7%	Analytical
NSC Foundation	Other	1%, 0.9%	Analytical

* The benchmark is based on the percentage of the Organization's consolidated assets and revenues, respectively. Our firm audited approximately 95% and 94%, respectively.

** A comprehensive response consists of an audit of the component's financial information, planned within the context of our overall audit of the Organization. A targeted response consists of the component auditor performing specific audit procedures that are determined by our firm to respond to identified risks.

In our auditor's report on the Organization, we make reference to the audit performed by the other unaffiliated auditors.

Use of the Work of Others

Specialists

Management relied on the work of Segal Consulting for the PERS actuarial assumptions used to arrived at the net pension liability and the pension related deferred inflows and outflows of resources. Similarly, management relied on the work of Aon Consulting for the PEBP actuarial assumptions used to arrived at the net other post-employment benefit liability and the other post-employment benefit related deferred inflows and outflows of resources. GT also utilized our internal valuation group to determine the reasonableness of the actuarial assumptions used by Aon Consulting. Management also relied on the work of STRATA Fund Services to assist in the valuation of alternative investments. GT used Harvest Investments to assist with testing the valuation of investments.

Commitment to Promote Ethical and Professional Excellence

We are committed to promoting ethical and professional excellence. To advance this commitment, we have put in place a phone and internet-based hotline system.

The Ethics Hotline (1.866.739.4134) provides individuals a means to call and report ethical concerns.

The EthicsPoint URL link can be accessed from our external website or through this link:
https://secure.ethicspoint.com/domain/en/report_custom.asp?clientid=15191

Disclaimer: EthicsPoint is not intended to act as a substitute for a company's "whistleblower" obligations.

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Audit Wrap Up Presentation

Technical Updates – GASB

Selected pronouncements effective for the year ending June 30, 2018 or subsequent periods - GASB

Title	Effective date
GASB 75- *Accounting and Financial Reporting for Postemployment Benefit Plans Other than Pensions*	Periods beginning after June 15, 2017
GASB 81- *Irrevocable Split-Interest Agreements*	Periods beginning after December 15, 2016
GASB 83- *Certain Asset Retirement Obligations*	Periods beginning after June 15, 2018
GASB 84- *Fiduciary Activities*	Periods beginning after December 15, 2018
GASB 85- *Omnibus 2017*	Periods beginning after June 15, 2017
GASB 86- *Certain Debt Extinguishment Issues*	Periods beginning after June 15, 2017
GASB 87- *Leases*	Periods beginning after December 15, 2019

GASB Statement 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*

Summary	Impact
• GASB 75 replaces the requirements related to OPEB accounting and reporting currently provided in GASB 45 and 57 • GASB 74 established new accounting and financial reporting requirements for the financial statements of the state and local government OPEB plans • State and local governments providing defined benefit OPEB plans administered through a trust meeting certain criteria must report a net OPEB liability on the face of their financial statements, similar to the requirement to report the net pension liability in accordance with GASB 68. • Provides a more comprehensive measure of OPEB expense than is currently required, which better reflects when the benefit cost is incurred. • Requires more extensive disclosures and required supplementary information • Effective for fiscal years beginning after June 15, 2017, with early adoption encouraged. Similar to adoption of GASB 68 (Pensions), retrospective adoption is required.	NSHE adopted GASB 75 in fiscal 2018 and reflected its share of the PEBP obligation as a cumulative effect of change in accounting at July 1, 2017. This resulted in adding a net liability to the financial statements of $ 491 million at that date.

GASB Statement 81, *Irrevocable split-interest agreements*

Summary	Impact
• Scope includes irrevocable split-interest agreement giving arrangements for which the government is the intermediary (trustee or agent) and a beneficiary, as well as beneficial interests in resources held and administered by third parties • Guidance establishes accounting for Lead Interests (government is a recipient of payments during the term of the agreement) and Remainder Interests (government is the beneficiary when the agreement terminates, and makes payments to non-government beneficiary – typically the donor or designee of the donor- during the term of the agreement) as well as life-interest in real estate and charitable annuity gifts. • Accounting requires recognition of an asset, liability and deferred inflow. When assets are held by third parties, the recognition will be an asset and a deferred inflow, with no need for a corresponding liability. There will be an annual re-measurement in subsequent periods. • Effective for periods beginning after 12/15/2016, with early adoption permitted. Retroactive application should be applied.	Adoption of this standard had minimal impact to NSHE.

GASB Statement 86, *Certain Debt Extinguishment Issues*

Summary	Impact
• The purpose of this guidance is to achieve consistency regarding accounting for the defeasance of debt irrespective of the source of funds set aside in an irrevocable trust for the purpose of funding the remaining debt (source of funds could be proceeds from a refunding arrangement or existing sources within the governmental entity). • New guidance clarifies the accounting for debt extinguishment when the source of the assets to be set aside in an irrevocable trust is existing resources rather than refund proceeds. When all of the other criteria for in-substance defeasance are in place, the debt is removed from the statement of net position and is disclosed in the footnotes in either scenario. • GASB 86 also requires that any remaining prepaid insurance related to the debt being extinguished must be included in the net carrying amount of that debt (to determine gain or loss on refunding). • Disclosures include a description of the transaction in the related period and remaining amounts outstanding in each subsequent period that the debt remains outstanding. • Effective for periods beginning after June 15, 2017, with early adoption encouraged. Changes to adopt this standard should be applied retroactively.	Adoption of this standard had minimal impact on NSHE. In the future, however, and depending on how universities fund the irrevocable trust related to debt extinguishments, the new standard may create additional situations where debt will be "removed" from the statement of net position, and disclosed in the footnotes to the financial statements. For universities considering future refundings, there is no longer a distinction in the accounting if the source of funds to be placed in an irrevocable trust are from existing resources or refunding arrangements.

GASB Statement 83, *Certain Asset Retirement Obligations*

Summary	Potential impact
• Objective is to develop requirements on recognition and measurement for asset retirement obligations (ARO), other than landfills (GASB 18) or pollution remediation obligations (GASB 49), such as nuclear power plants and sewage treatment facilities • The pronouncement addresses the following: - Establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources when a governmental entity has a legal obligation to perform future asset retirement activities related to its tangible capital assets - Proposes capitalization of the ARO as a deferred outflow of resources, to be amortized in a systematic and rational manner (such as the straight-line method), generally over the life of the related asset giving rise to the obligation - Requires disclosures regarding governmental entity legal requirements to provide funding or other financial assurance for their performance of asset retirement obligations (e.g., how are those requirements being met) as well as nature and timing of AROs, method used to determine the estimated liability and useful life of the associated tangible asset. • Effective for periods beginning after June 15, 2018. Earlier application is encouraged.	Similar to the efforts Universities underwent when adopting GASB 49, management should inventory any activity whereby there is a related obligation to dispose of certain assets subject to regulatory and legal requirements. With that list, management must calculate the expense of that effort and track it annually. The effort to inventory these assets/costs may requirement input from facilities and potentially other areas of the University and the process to estimate costs of future events may also require assistance from facilities and other departments.

GASB Statement 84, *Fiduciary Activities*

Summary	Potential impact
• Guidance addresses the following: - The categorization of fiduciary activities for financial reporting - How fiduciary activities are to be reported - When liabilities to beneficiaries must be disclosed • Types of fiduciary funds that must be reported include the following: - Pension (and other employee benefit) trust funds - Investment trust funds - Private-purpose trust funds - Custodial funds • A government controls the assets of an activity if it holds the assets or "has the ability to direct the use, exchange or employment of the assets in a manner that provides benefits to the specified or intended recipients" • Fiduciary activities must be disclosed in the basic financial statements of the government entity and a statement of fiduciary net position and changes in fiduciary net position should be presented (unless the period of custody is less than three months). • Effective for periods beginning after December 31, 2018, with early adoption encouraged.	Universities often will agree to act as a fiduciary for certain third party organizations that might be somehow affiliated to the university (such as student clubs, alumni clubs, or other such organizations). Under this new requirement, the University must report the fiduciary activity on its financial statements, where it may not have done so in the past. Management should identify which fiduciary activities it is engaged in to inventory the relationships which may need to be reported. Management may want to consider changing the terms of the relationships such that they are not subject to reporting on the financial statements of the University when the requirement becomes effective.

GASB Statement 87, *Leases*

Summary

- The GASB recently issued guidance which resembles the recently issued FASB guidance on leases.
- To determine whether a lease exists, a government should assess whether it has both:
  1) The right to obtain the present service capacity from use of the underlying asset as specified in the contract, and
  2) The right to determine the nature and manner of use of the underlying asset as specified in the contract
- For Lessees:
  - In general, all leases will be reported on the statement of net position (the distinction between operating and capital leases is no longer relevant) as a "right of use" asset and a corresponding lease liability within long term debt
  - On the statement of changes, rent expense will be replaced by amortization expense of the right-of-use asset as well as interest expense on the lease liability (thus accelerating expenses in the beginning years of the lease term)
  - There is an exemption for short term leases (those with a term of 12 months or less, including extension options) as well as leases that transfer ownership at the end of the term
  - Disclosures regarding matters such as total leased assets by major class of underlying assets and related accumulated amortization (in total), principal and interest payments for each of the five subsequent fiscal years and in five year increments thereafter and commitments under leases before a lease commencement period, among other items
- Effective for periods beginning after December 15, 2019, with early adoption encouraged. Existing leases will be adjusted based on the remaining lease payments as of the beginning of the period of adoption or beginning of any earlier periods restated (for example, for June 30 year ends, adoption is June 30, 2021 so the beginning period is July 1, 2020).

GASB Statement 87, *Leases* (continued)

Potential Impact
For those universities which use operating leases to finance certain capital activities, this standard could have a significant impact on the financial statements of the University upon adoption. Management should consider the impact on financial covenants, as well as ensuring a complete inventory of existing leases that will be subject to the new accounting and disclosures.

GASB projects

Project	Timing
Financial Reporting Model- Reexamination of Statements 34, 35, 37, 41 and 46, and Interpretation 6	Evaluation of feedback from Invitation to Comment in process, planned issuance of final standard in 2022.
Debt disclosures, including Direct Borrowing	Final draft expected to be issued in March 2018
Revenue and expense recognition	Initial deliberations, with an Invitation to Comment expected in early 2018.
Recognition (conceptual framework)	GASB is redeliberating on results from comments on preliminary views
Capitalization of Interest Costs	Exposure draft available for comment through March 2018, with a final statement expected in June 2018
Conduit Debt- Reexamination of Interpretation 2	Recently added to the agenda
Equity Interest Ownership Issues	Exposure Draft comment period recently ended, currently in redeliberations, with final statement expected August 2018
Implementation Guide- GASB 84 (Fiduciary Activities)	Material for Guide in development, final Guide expected to be available in May 2019
Implementation Guide- GASB 87 (Leases)	Material for Guide in development, no current date for release is available

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Audit Wrap Up Presentation

Industry Updates

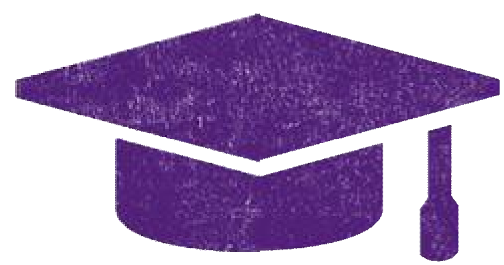
Key Themes in 2018

Good news:

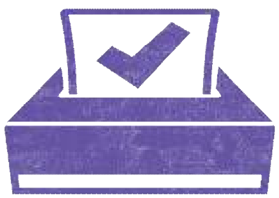
- Colleges and universities are holding steady, with flat or modest revenue increases accompanied by warning signs
- More and more experiments with "business model" are occurring

Not so good news:

- Revenue is highly constrained with limited prospects of improvement
- Price sensitivity (restraint on net price increases) continues
- Demographics worrisome in East and Midwest
- Washington policies may harm but won't help



Washington Update: New Tax Law



Plus many, many little surprises like employee moving expenses now being taxable

1 **Endowment spending lowered**: 1.4% excise tax on net investment income. Applies if over 500 students and $500M in assets per FT student. Excludes assets "directly used to carry on educational purposes."

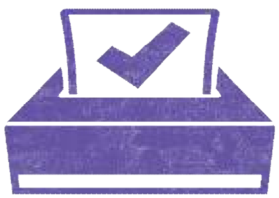
2 **Excise tax on executive comp**: 21% excise tax on comp of "covered employee" in excess of $1M ("covered" if one of five higher compensated for organization)

3 **Likely increase in unrelated business income tax**. No "bucketing" or "netting." Loss of one activity can't be used to offset gain of another.

4 **Fund raising more challenging**. Increase in standard deduction eliminates tax incentive for those who don't itemize. Doubling of estate tax exemption may reduce charitable giving to reduce or eliminate estate tax.

5 **Weakened state support for public higher education:** The cap on the state and local tax deduction puts additional pressure on state budgets

Washington Update: Immigration & Isolation



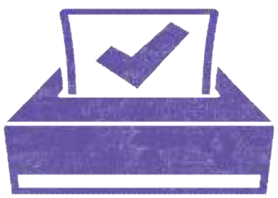
1 **Immigration, including DACA**: Negative impact on trend toward globalization: insecurity of existing students & faculty, less international students (see below) & faculty; stifled programs abroad

2 **International Student Enrollments Down**: Applications & enrollments dropped this fall, especially at the graduate level and in non-elite institutions

States:

1 **"Free tuition**: Being proposed by governors and adopted in in some states. Generally good for public institutions. Potential negative impact on private colleges in those states.

Washington Update: Higher Education Act*



1. **Federal aid (grants)**: Continues Pell Grants but limits or eliminates other aid programs.

2. **Federal aid (loans)**: Ends the Public Service Loan Forgiveness Program. Caps the amount graduate students may borrow at $150K. Ends Federal Direct Loan Program for new borrowers starting July 1, 2019.

3. **Free Application for Federal Student Aid (FAFSA)**: Asks Secretary to simplify the FAFSA and create mobile-optimized tool.

4. **Accreditation**. Accreditors required to identify annually institutions that are at risk of failing to meet their standards and key metrics. At least one public member on accrediting commission would be required to represent the business community

5. **Protects for-profit education**. Repeals "gainful employment" regulation, weakens "borrower defense" regulation; tells DOE to use "single definition of institution"

*House version

Moody's

"Negative" after two years of "stable"

Revenue:

- Growth in revenue will not keep pace with growth in expenses
- Increases of tuition revenue, research funding and state contributions will "remain subdued"
- "A market that is increasingly sensitive to higher education's price v. perceived value"

Expenses:

- Labor costs
- "Need to sustain investments" in programs, facilities, and technology

Private Sector

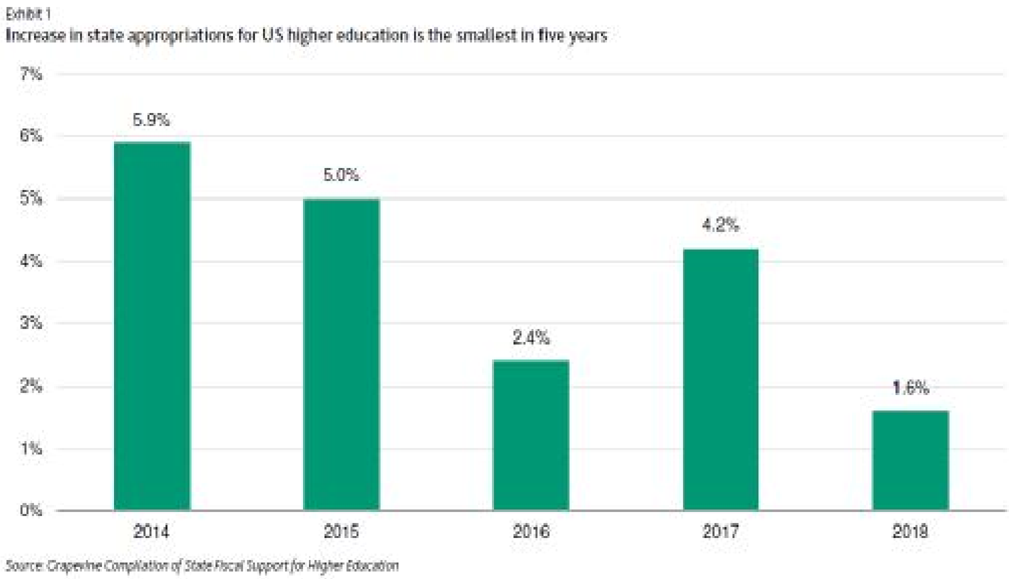
- More than half of private institutions will achieve growth of at least 3%
- Net tuition growth in the 3-3.5% range for private universites and "lower net tuition growth" than universities for small & medium sized institutions
- Growth in "first year discounting" is a worry

Public Sector

- Less than 20% of public, four-year institutions will see their revenue increase by more than 3%
- Net tuition growth in 2-3% range "as they face increasing political constraints, including state limits on raising tuition"
- Tuition freezing and lowering is gaining traction
- More states likely to mandate mergers & reorganizations

All sectors: decline of high school graduates in Northeast & Midwest (over 5% through 2025)

"Slow growth in state support strains public universities' budgets"*



- Smaller state funding increase is "credit negative" for public universities
- "Effects of the limited funding increase will be greatest for small public universities, for which almost 30% of operations are paid for with state appropriations."
- Public universities, especially regional universities, have "consumed much of their pricing power" so tuition increases can't offset state support

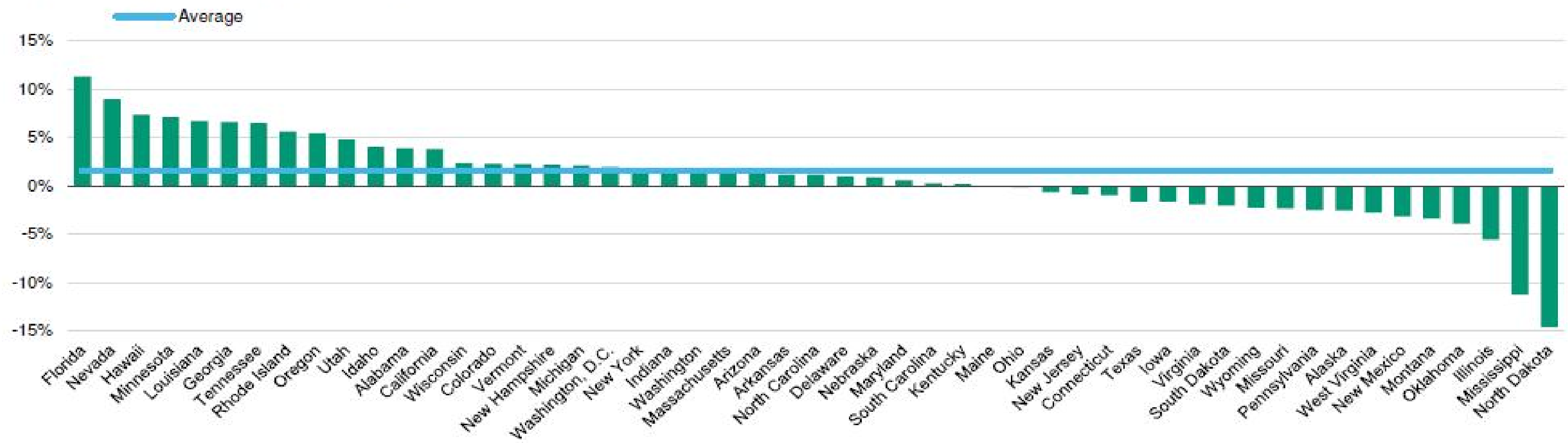
*Title of Moody's report issued 1-29-2018

Changes in support vary significantly by state

Exhibit 2

Wide disparity in 2018 state appropriations for higher education

One-year change in state support for higher education



Source: Grapevine Compilation of State Fiscal Support for Higher Education

Moody's report issued 1-29-2018

Moody's

"Negative" after two years of "stable"

Federal policies:

- Tax law could hurt fund raising
- Immigration policies and tone is hurting international enrollment
- Uncertainty around potential future changes in tax policies and in Federal student aid policies

MOODY'S

"Negative" after two years of "stable"

Opportunities:

- International recruitment
- Expansion of online and certificate programs
- Attracting transfer students and improving retention

Standard & Poor's 2018 Sector Outlook

S&P Global
Ratings

Opportunities

- Increase and emergence of innovative strategies and partnerships
- Change in institutions' view of ideal target student profile

Risks

- Multiple implications from the recently enacted Tax Cut and Jobs Act
- Decrease in capital markets activity due to rising interest rates and curtailment of advance refundings
- Widening gap between students' expectations and their willingness to pay

Citing changes in Federal policy, S&P also switches to "a negative outlook"

Standard & Poor's 2018 Sector Outlook

S&P Global
Ratings

Some quotes from S&P

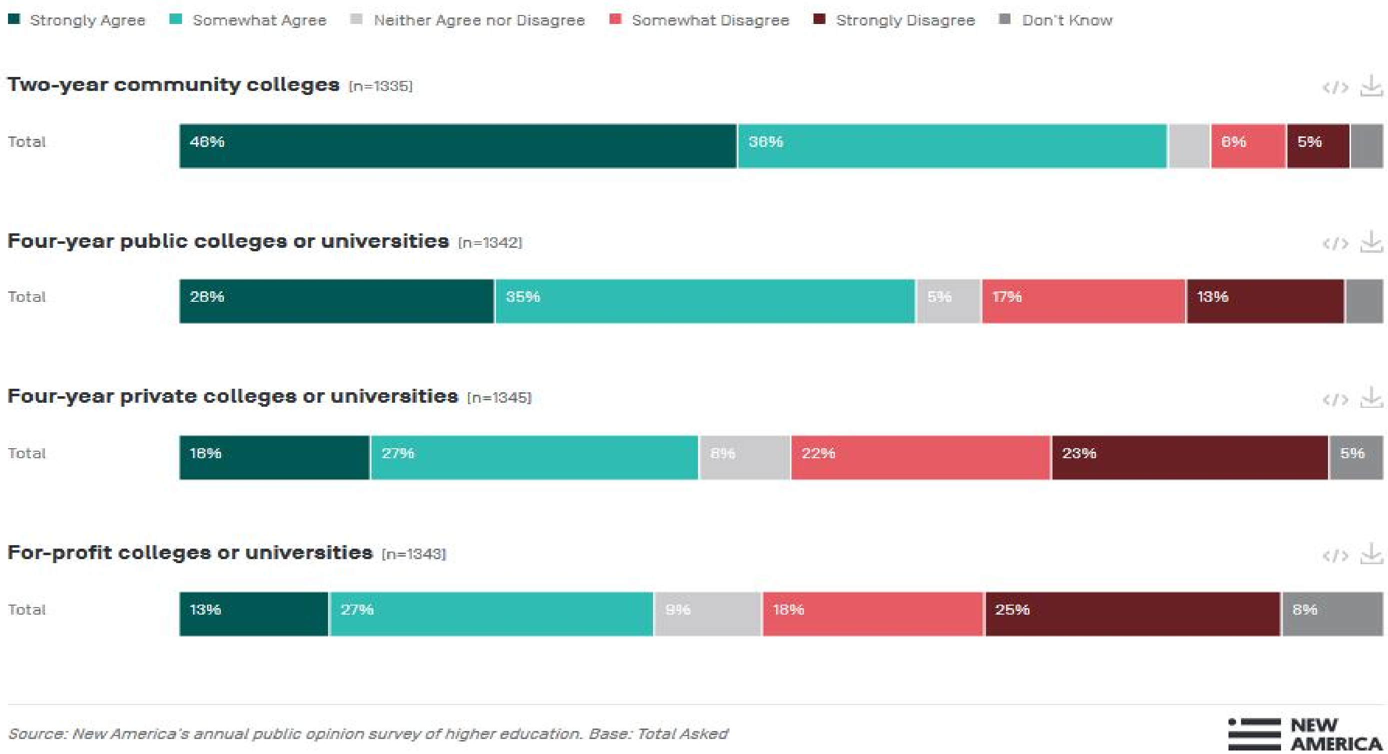
"Students and parents seek stagnation in or decrease in the cost of attendance while demanding even bigger increases and improvements to facilities, amenities, and services."

"Colleges and universities seem more open than ever before to adopting nontraditional or new strategies and partnerships……We expect institutions will continue to explore creative ways of doing business to combat the challenges of the current operating model."

NEW AMERICA

2017 annual survey of American public opinion on higher education

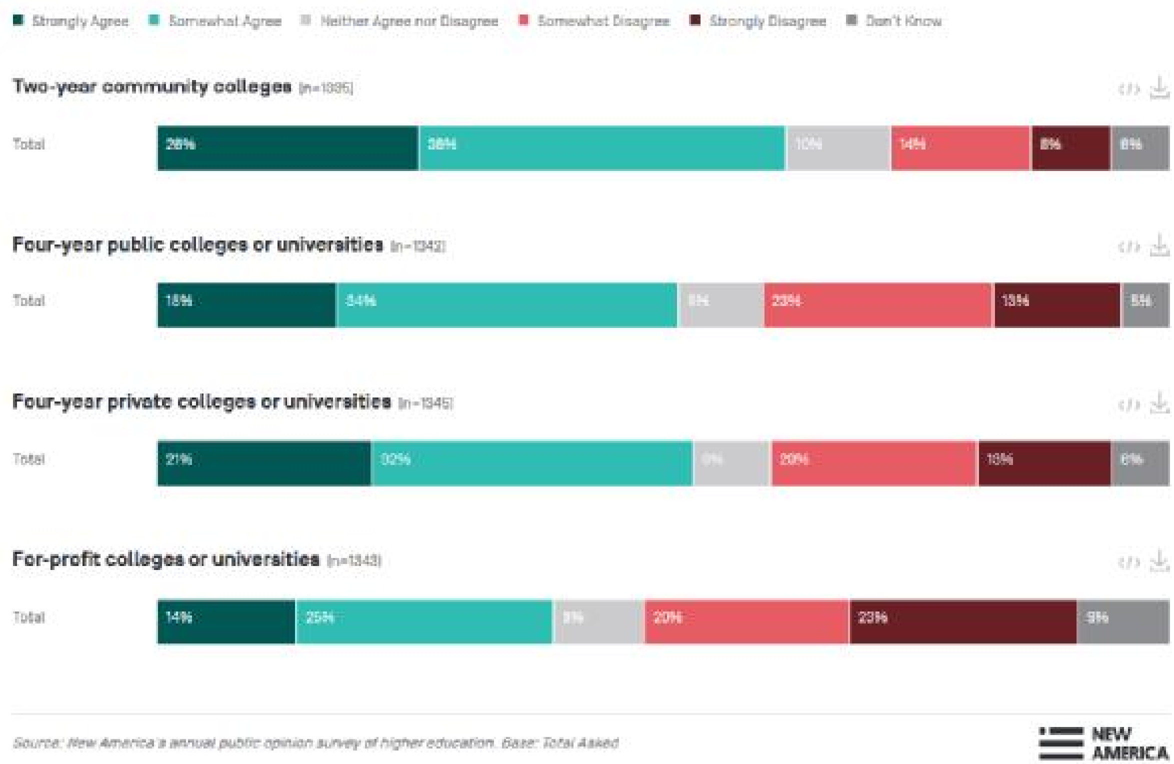
Agree or disagree: [Institution type] is worth the cost.



NEW AMERICA

2017 annual survey of American public opinion on higher education

Agree or disagree: [Institution type] always puts their students first.



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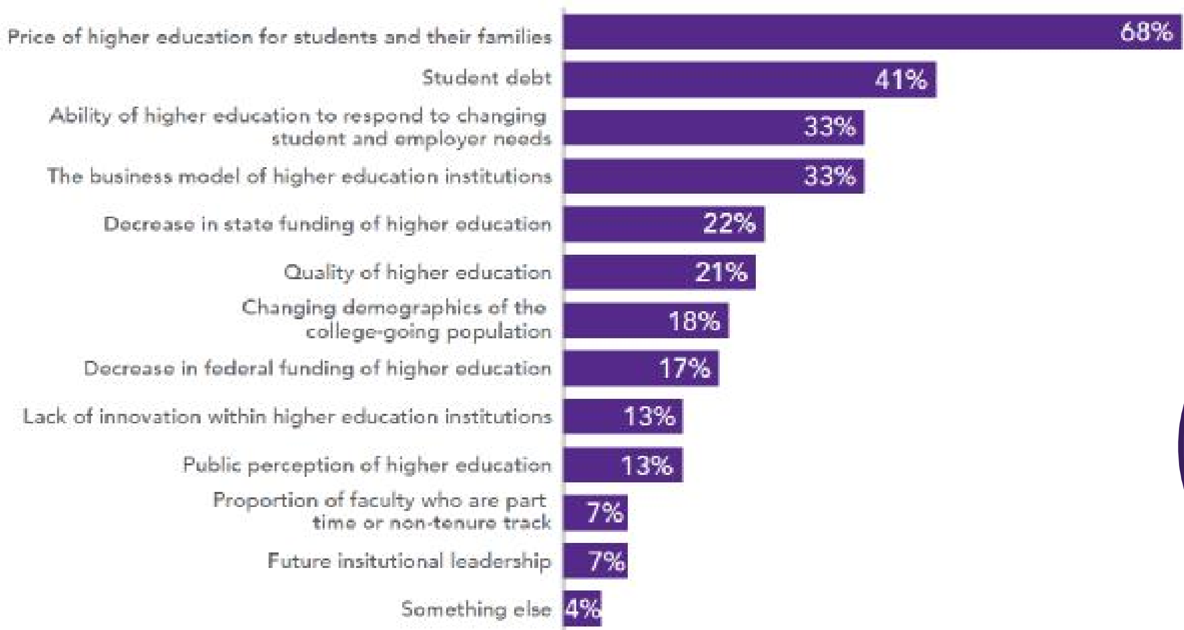
AGB ASSOCIATION OF GOVERNING BOARDS OF UNIVERSITIES AND COLLEGES

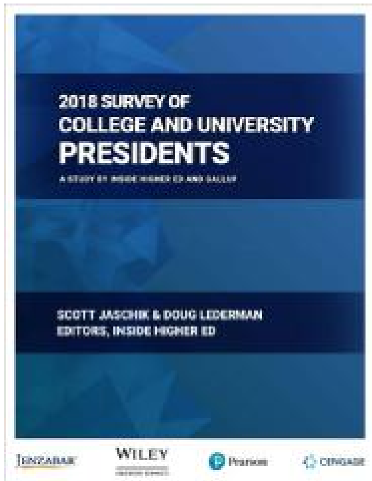
2017 survey: % of trustees who identified issue as one of the top three "concerns about the future of higher education"



Note: Respondents could choose up to three choices.
Percentages are calculated based on the number of respondents.

Affordability is top issue for trustees

"Confident my institution will be financially stable"



Over five years..........

63%
All institutions "agree" or "strongly agree"

62%
Public universities "agree" or "strongly agree"

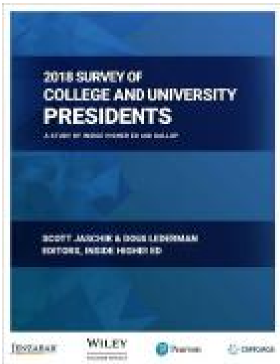
61%
Nonprofit private colleges "agree" or "strongly agree"

Over ten years..........

53%
All institutions "agree" or "strongly agree"

47%
Public universities "agree" or "strongly agree"

57%
Nonprofit private colleges "agree" or "strongly agree"



"Confident my institution will be financially sustainable over ten years"

Elite Private Universities	Elite Private Colleges	Public Flagship Universities	Private Colleges
84%	89%	68%	13%

Private tuition dependent colleges see themselves as most at risk!

What do business officers say?

- Only 54% are confident in their institution's financial stability over the next ten years *(Inside Higher Ed survey in 2016)*
- One in four complained about "resistance to change" on their campuses *(NACUBO survey in 2016)*

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Price resistance

Price resistance is growing.

- 18.6% of students who were admitted to their top choice of college or university in 2016, but decided not to go there, turned it down because of the cost of attendance
- 39.9% who turned down their college of first choice did so for a reason related to cost, such as financial aid received from another college, non-need based scholarships, or "a college's value"
- Results not much different between SAT score levels or minority status

Reason for Not Attending College of First Choice	Percentage of Students Citing
Cost of attendance	18.6%
Campus environment	9.4%
Location of the school	9.3%
The financial aid I received	9.1%
Academic reputation	8.1%
Proximity to home	7.6%
Offered the major I wanted	6.6%
The merit-based scholarship I received	6.3%
Best value	5.9%
Reputation in my intended field of study	4.9%
The size of the school/number of students	3.8%
Athletic programs	3.3%
Overall Reputation	3.0%
Legacy/family member attended the school	1.8%
Amount of contact after admission	1.1%
Timing of my financial aid award	1.0%
Amount of contact before application	0.4%

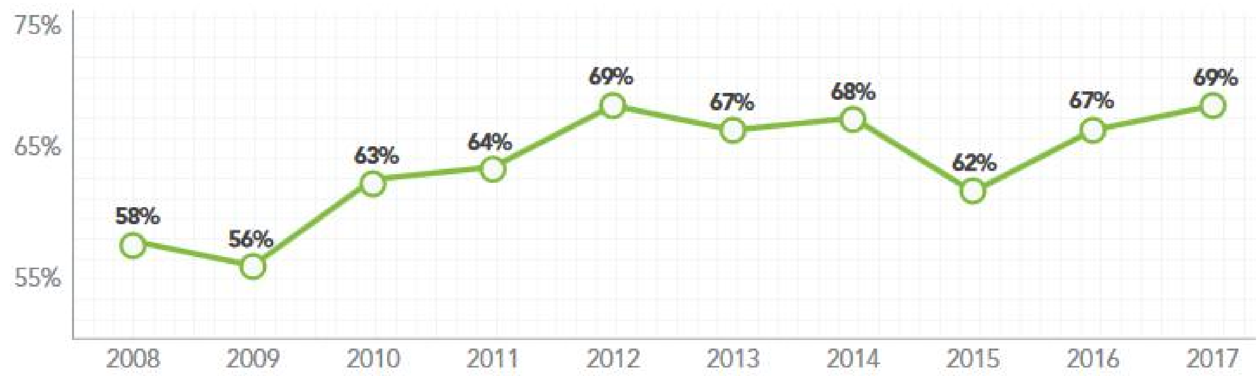
Price resistance

Price resistance is growing.

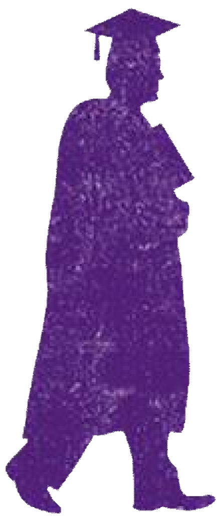
Last year, 69% of parents/prospective students eliminated some colleges from their selections because of cost, a number that jumped from 58% ten years ago.

Figure 5

Elimination of Colleges from Selection Set Due to Cost, over Time



Net tuition revenue pressures



Chronicle of Higher Education survey:

- Four in ten private colleges and almost three in ten public ones missed their goals for enrollment and net tuition revenue in 2016, a track record similar to the prior three years.

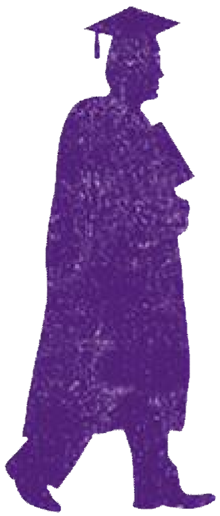
College Board:

- Net tuition revenue has been essentially flat in the two years most recently available, for private baccalaureate and master's level colleges

Moody's

- "Low gains in tuition revenue are the 'new normal' for colleges" and
- “Institutions that lack a distinct brand or strong value proposition are bearing the brunt of an increasingly value-oriented consumer"

Net tuition revenue pressures (continued)



NACUBO Tuition Discounting Study:

- Net revenue growth projected at just over 1% for freshman, a decrease from prior year, and 37.5% of institutions had enrollment declines among both first-year classes and their entire student bodies from 2014-15 to 2015-16.
- More than half of institutions, 51.2%, reported a decrease in total undergraduate enrollment, and 53.5% said freshman enrollment dropped.

Endowment returns low over time

NACUBO

NACUBO/Common-fund Study of 809 endowments for FY2017:

- The ten year average annual return fell to 4.6% from 5.0%
- 65% of endowments reported increasing their effective spending rate; the median increase being 6.5%

Colleges and universities with spending rates above this annualized annual return:

- Could be eroding the purchasing power of their endowments over time.
- Should reassess their spending rates and consider lowering them.

Top IT Issues in Higher Education in 2018

EDUCAUSE

1. **Information Security**. Developing a risk-based security strategy that keeps pace that keeps pace with security threats and challenges

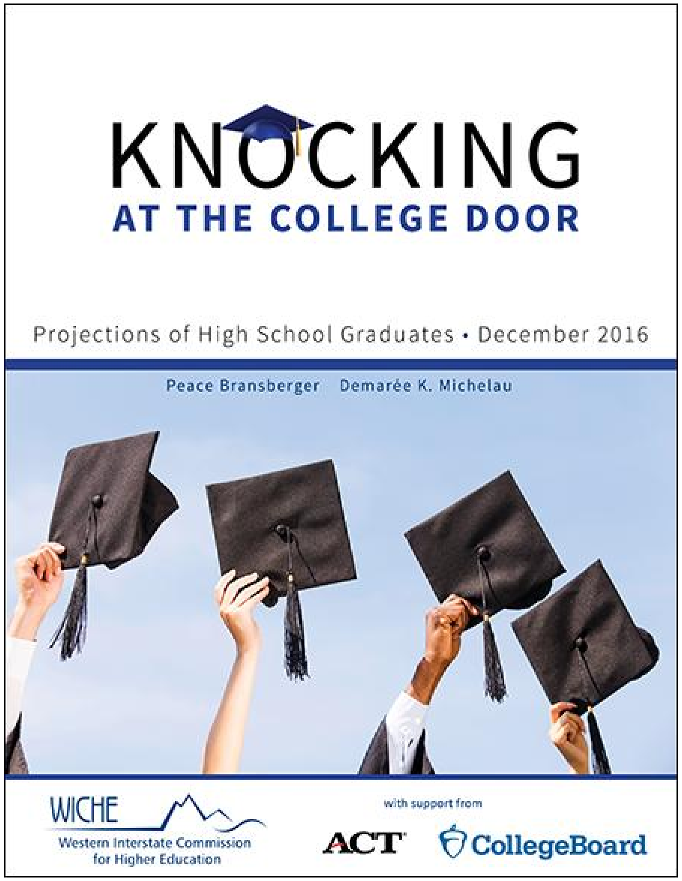
2. **Student Success**. Managing the systems implementations that support multiple student success initiatives.

3. **Institutional-Wide IT Strategy**. Repositioning or reinforcing the role of IT leadership as an integral strategic partner of institutional leadership in achieving institutional missions

4. **Data-Enabled Institutional Culture**. "Using BI and analytics to inform the broad conversation and answer big questions.

Demographics

- Number of high school graduates
  - Plateau nationally starting in 2019
  - Ongoing declines in East and Midwest
- Ethnicity of higher school graduates
  - Decline of non-Hispanic whites
  - Growth of Hispanics



WICHE 9th Ed., issued Dec. 2016

What are colleges doing to generate financial return?

Innovation/ Strategy

- Targeting new populations
- Different pricing strategies
- Different locations, including cyber & satellite campuses

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What are colleges doing to generate financial return?

Academic Modes

- Retention
- Online and hybrid programs
- Credentials (certificates & other "micro" credentials for competencies, 3 year degrees, joint degrees, masters)

What are colleges doing to generate financial return?

Management

- Data analytics
- Understanding costs (& using that information for decision making)
- Sharing services
- Faculty productivity (workload, sabbatical policies, types of appointments)
- Outsourcing
- Budgeting by substitution

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What are colleges doing to generate financial return?

Governance

- Intensifying shared governance (working effectively with faculty).
- Board more focused on strategy than oversight
- Presidents are pro-active strategists, innovators, & risk takers

What some universities are doing but should not

- Overspending from endowment
- "Borrowing" from endowment / restricted funds
- Using debt, in excess, for liquidity purposes
- Running deficits without a plan
- Overbuilding
- Selling physical assets without a plan
- Deferring maintenance

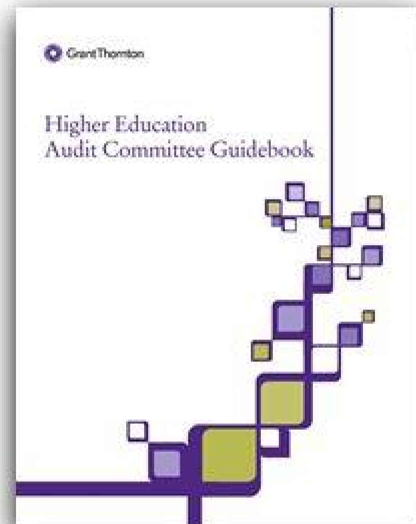
"A college's greatest enemies are complacency and nostalgia"

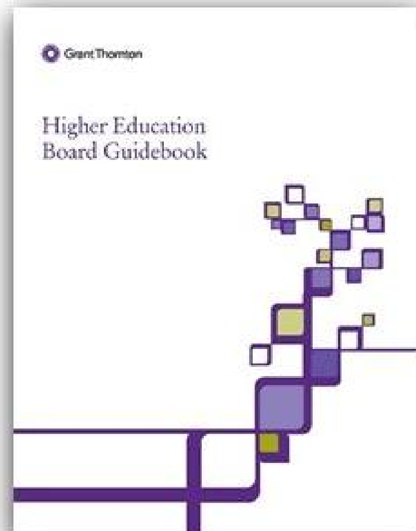
Changes to consider going forward

- Making the case for value of higher education
- Developing capacity for change
- Delivering education in different styles and formats (including cheaper)
- Finding paths to success for new student populations
- Adjusting to lower net student revenue and modest growth in government support
- Holding all stakeholders committed to common purpose

Additional resources

www.grantthornton.com/industries/NFP





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