# Related-Party & Audit Considerations for Upcoming ED Oversight Rules

In October 2023, the U.S. Department of Education (ED) released final rules to improve monitoring and oversight of higher education institutions and strengthen consumer protection for student borrowers. As the effective date draws closer, this article focuses on the audit and related-party financial statement requirements of the new rules.

| Effective Date | **Audited Financial Statements** submitted to EZ Audit **after July 1, 2024** |
|---|---|

## Background

The October 2023 final rules cover four areas:

- **Financial responsibility**. The ED states these changes will increase its ability to identify high-risk events and swiftly obtain financial protections like a letter of credit when an institution exhibits certain warning signs. This section also includes the updates to the audit and related-party requirements.
- **Administrative capability**. This new guidance will improve the ED's ability to evaluate the capability of institutions to participate in the Title IV, Higher Education Act programs. The changes enhance financial aid communications to the student to include the institution's cost of attendance; the source and type of aid offered; whether aid must be earned or repaid; the net price; and deadlines for accepting, declining, or adjusting award amounts. Institutions also must show they have sufficient resources and procedures in place for areas like career services and financial aid communication to participate in federal student aid programs.
- **Certification procedures**. These updates address the conditions the ED can place in the written agreements it has with colleges to participate in federal student aid programs.
- **Ability to benefit**. These amendments create a process for states to approve postsecondary programs that serve students who do not have a high school diploma.

In addition, in September 2023, the ED issued final rules addressing financial value transparency covering all higher education institutions and gainful employment for programs offered by private for-profit institutions and certificate programs at all types of colleges. These rules also are effective beginning in July 2024. For details on those provisions, see our article, "Steps Institutions Should Take With DoE's New Gainful Employment Rule."

## Audit Requirements

- For fiscal years beginning after July 1, 2024, financial statements submitted to the ED must match the fiscal year of the entity's annual IRS returns. This provision has a different effective date than other changes to allow institutions time to realign tax and financial statement dates, if required.
- For domestic U.S. institutions, financial statements must be prepared on an accrual basis in accordance with GAAP and audited by an independent auditor in accordance with generally accepted government auditing standards (GAGAS).
- For institutions other than those receiving a Single Audit, audit reports must be submitted on a timely basis—the earlier of 30 days after the completion of the report or six months after the end of the institution's fiscal year. This aligns deadlines for public, private nonprofit, and proprietary institutions. There is no change for institutions already complying with Single Audit requirements for which the deadline is the earlier of 30 days after the completion of the audit or nine months after the end of the fiscal year.

When there are separate auditor signature dates on the audited financial statements and the compliance audit, the relevant date is the later of the two dates.

## Related Parties

Currently, institutions are required to submit details about related entities based on the definition in Accounting Standards Codification (ASC) 850, *Related Party Disclosures*. The new required disclosures are broader than those in ASC 850. Those broader disclosure requirements include the identification of all related parties and a level of detail that would enable the ED to readily identify the related party, such as the name, location, and a description of the related entity, and the nature and amount of any transactions between the related party and the institution, financial or otherwise, regardless of when they occurred and regardless of the amount.

*Per ASC 850-10-20, related parties include:*

*a) Affiliates of the entity*

*b) Entities for which investments in their equity securities would be required*

*c) Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management*

*d) Principal owners of the entity and members of their immediate families*

*e)* ***Management*** *of the entity and members of their immediate families*

*f) Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests*

*g) Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests*

The FASB master glossary notes that management normally includes members of the **board of directors.** In addition, other potential examples of a related party that can exercise control or significant influence over an institution could include—but are not limited—the following:

- Immediate family members of the organization's board of directors or management team
- Affiliated national, state, or local organizations
- Organizations under common control
- Organizations with shared board members or members of management
- Businesses owned by any of the previously mentioned parties

Some common transactions that may require disclosure if an entity engages in them with a related party:

- Purchases of goods or services
- Receipt of contributed goods or services
- Monetary contributions received
- Purchase or sale of assets
- Leasing a building
- Using donated space
- Borrowing or lending funds
- Maintaining bank accounts at a financial institution that employs a board member

| Related-Party Disclosure Requirements | |
|---|---|
| **ASC 850** | **Section 668.23** |
| Financial statements shall include disclosures of **material related-party transactions**, other than compensation arrangements, expense allowances, and other similar items in the ordinary course of business. | Disclosure requirements extend beyond ASC 850 to include **all related parties, regardless of amount**. If there are no related parties, this must be disclosed. |
| The disclosures shall include:<br>a. The nature of the relationship(s) involved<br>b. A description of the transactions and other such information to understand the effects of the transactions on the financial statements<br>c. Dollar amount of transactions for each of the periods presented<br>d. Amounts due from or to related parties<br>If necessary to the understanding of the relationship, the name of the related party shall be disclosed. | Information **must** include—but is not limited to—the name, location, and a description of the related entity, including the nature and amount of any transactions between the related party and the institution, financial or otherwise, regardless of when they occurred. |

If there are no related-party transactions during the audited fiscal year or related-party outstanding balances reported in the financial statements, then management must add a note to the financial statements to disclose this fact.

The ED has stated the reason this information is of interest to it is that related-party transactions are relevant to determine whether audited financial statements should be submitted on a consolidated basis or combined basis. Related-party transactions also may require adjustment to the calculation of an institution's composite score.

In determining whether an institution is financially responsible, the ED also may require the submission of audited consolidated financial statements, audited full consolidating financial statements, audited combined financial statements, or the audited financial statements of one or more related parties that have the ability—either individually or collectively—to significantly influence or control the institution, as determined by the ED.

## Response to Comments on Proposed Regulation

As part of the ED's issuance of the final rule, it included responses to comments received on the proposed regulations.

- One comment indicated the related-party information could be obtained from the publicly available 990 filing. The ED's response stated that there are errors in that information because it is not audited.
- There was a question on what constitutes all related-party transactions. Would providing meals to board members at a board meeting be a related-party transaction? The ED responded that routine items such as meals provided to all board members during a working lunch would not be a related-party transaction, since the meals would be incidental to supporting a board meeting. Transactions with individual board members for other services provided to the institution or a related entity would be reportable.
- Another concern states the required disclosures constitute personally identifiable information (PII), which is not allowed to be included in a Single Audit uploaded to the Federal Audit Clearinghouse (FAC). The ED responded that it is not requiring this information to be made publicly available.

## Practical Considerations

- Review internal controls to ensure the identification of related parties, as well as all transactions involving those parties.
- Reassess the institution's policies and procedures for the approval of related-party transactions and capture of additional newly required disclosure details.
- Consider if multiple versions of audited financial statements will need to be issued to comply with ED regulations separate from the Single Audit requirements to not include PII in audits submitted to the FAC.
- Consult with your auditor to discuss how the disclosure requirement will impact the audit and auditor's opinion.

## Conclusion

From regulatory demands to increased competition, the challenges for higher education leaders have never been greater. Our extensive experience with colleges and universities means you work with a highly qualified team that's passionate about helping address your unique challenges. For more information, visit forvis.com.

## Contributors

**Anne Coughlan**
Director
anne.coughlan@forvis.com

**Jackson Magdy**
Director
jackson.magdy@forvis.com