

## **ACERS (Accounting Certification Exam Remuneration System): Using Securitization to Solve a Persistent Business Education Funding Problem**

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### **Abstract**

*While student loans are available to support the accounting student while enrolled in an accounting degree program, there exists no formal system of financial support for the accounting graduate during a post-graduation period of intensive certification exam preparation. Current practice usually entails recent accounting graduates taking employment, and then, usually with the blessing of the employer, studying after-hours for the certification exam. Naturally, this arrangement would be expected to reduce the probability of the candidate passing the exam and extend the time required to pass all components of the exam relative to full-time study. Loan Securitization is the process whereby loans with similar characteristics are pooled and then used to back more easily traded securities. The advantage of this approach is the transformation of relatively illiquid claims into a format which can be traded in the more liquid capital markets. Thus, securitization is essentially a method of facilitating the interaction between providers and users of capital. Loan securitization has been used in many different settings. This paper proposes the use of loan securitization as an approach to channeling funds to graduates in transition who are attempting to pass professional certification exams.*

**Keywords:** Accounting Certification Exams, Loan Securitization

### ***1. The Problem: Intensive Preparation for Certification Exams***

Students training for careers as professional accountants face an awkward period of transition at the time of graduation. While a successful career in accounting may hinge on successful completion of a professional certification such as the CPA or CMA, the typical recent graduate who takes full time employment reduces the probability of quickly passing the associated examinations in doing so. Even when the recent graduate's employer is supportive of the student's efforts to prepare for the professional certification exams, the demands and pressures of the workplace significantly impact the individual's ability to effectively prepare.

It is generally held that a recent accounting graduate is most likely to successfully complete the professional certification exams if he or she is able to engage in an intensive review and study period immediately after completing the formal degree program. At that point in time, the graduate's knowledge gained in the accounting program is at its peak. In an ideal world, an accounting graduate would begin the period the period of intensive examination preparation immediately after graduation and would dedicate his or her efforts entirely for the one to three month period which traditionally might have been expected for effective preparation.

The recent transition of the CPA exam to the new computerized format has given greater flexibility to those preparing. Now that a student can take one section of the exam at a time (with up to 18 months to complete after one passed section), it would be expected that it would be easier to find study time during full-time work. However, according to the AICPA, even though the number of accounting graduates has increased in recent years, the number of individuals taking the CPA has declined significantly [Metzer]. Further, it appears that the number of CPA exam takers declined in year of introduction of the new computerized exam [Edmonds]. The results of a recent study conducted by a joint task force of the American Institute of CPAs, the National Association of State Boards of Accountancy, and Prometrics suggest that the primary reason for candidates not taking the exam is that they do not have enough time to prepare [Edmonds].

Further, the study indicates that although accounting employers believe that they offer support for candidates, the employees themselves feel that they are not given enough time to prepare. The same study suggests that candidates also do not feel a particular sense of urgency with respect to the passing of the exam.

One alternative to the current situation would be to develop a system whereby promising candidates could transition from full time study in the undergraduate program to a period of full-time intensive exam preparation. Unfortunately, traditional student loans require the student to be an active enrolled student for the provision of additional funds. Consequently, even though repayment of existing loans might not be required immediately, there is strong pressure for students to take employment just after graduation to cover expenses. If a special form of short-term funding were available to support appropriately selected candidates, then most likely, more candidates would move more rapidly through the certification exam process.

The problem with this type of loan is that such loans would tend to be for short duration and relatively small amounts relative to other study related financing. Thus, it would be expected that the emergence of such financing would require some type of special inducement (such as government guarantees) or some specific sponsorship as catalyst (such as an industry group initiative). However, if such loans could be pooled and securitized, the result might well be to gain the attention and participation of the larger capital markets.

## **2. Loan Securitization**

Securitization in the most general sense is the transformation of a financial relationship into a financial transaction [Fabozzi & Kothari]. Securitization depends on a claim to a set of future cash flows. If one has rights to a set of future cash flows, one can sell those rights. If the right characteristics are present, the cash flows can be associated with a security which can have significantly different market presence than the relationship which gave rise to the cash flows. While any set of future cash flows might be securitized, market participants are at present most likely familiar with loan securitization.

Loan Securitization is most frequently used when the financing arrangements involve relatively small increments of debt which are created in individual transactions. For securitization to work, the individual debt transactions must be basically similar. At present, securitization is widely used in the repackaging for the larger capital markets of various types of consumer level loans. Securities based on this pooled loan concept currently exist for automobile loans, housing loans, and student loans.

Loan securitization can be seen as freeing financial institutions from the traditional funding role they played in the past. The other roles of financial institutions such as monitoring may persist in the presence of securitization of loans. [Scott].

The key to securitization is that the individual claims be similar enough to serve as rough substitutes for each other. Thus, the pool of claims upon which the security is based is simply a portfolio of similar, though not necessarily identical, financial instruments. For best results, the underlying claims must be well documented with estimable default and pre-payment rates. Aside from these basic requirements, essentially any type of loan could be used in the process.

The specific characteristics necessary for loans to be appropriate for securitization are generally agreed upon. First, there must be a considerable degree of standardization in the loan product [Scott]. Second, the cash flows associated with the loans must be clearly defined or readily estimable. Third, the loans should have relatively low risk. Frequently, lower risk loans are associated with assets which readily serve as collateral [Scott]. However, low risk need not necessarily be associated with collateral.

## **3. Securitization of Future Individual Earnings Streams**

In recent years securitization has broadened to include star athletes and musicians. Indeed, plans are currently underway to introduce a formal market for securities based on the future earnings of professional athletes [Lewis]. In the case of the proposed *ASA Sports Exchange*, the securitized cash flows would be 20% of all future sports related earnings. Similar concepts are loose in the European marketplace with at least one hedge fund which runs a portfolio of soccer players. Such approaches have been referred to as the “intellectualization” of pro sports, in which valuations (and salaries) are moving away from the gut estimates of insiders to more formal statistical valuation approaches [Lewis].

Rock star David Bowie famously securitized his future royalties earnings. However, securitization of intellectual property has not advanced as quickly as was originally anticipated [Walsh]. This may be due in large part to the difficulty of estimating the size and pattern of the associated cash flows. The limitations to growth in the securitization of future individual earnings cash flow streams appears to arise from the difficulty or ease of estimating the future cash flows. Presumably, if the earnings stream of an individual were readily estimable, securitization of that stream would be relatively straightforward.

#### **4. Earnings Patterns in Professional Accountants**

Considerable data is available on expected salaries of certified accounting professionals. Data is also available which demonstrates the salary premium derived from successful completion of professional certification in the accounting field.

Using the 2007 Robert Half and Accountemps Salary Guide data, the authors compared the reported lifetime earnings of accounting professionals with and without professional certification in small, medium, and large accounting firms. Assuming a reasonable discount rate for present value calculations, the implied differences are significant. Certification clearly provides a differential future earnings stream. This differential itself could provide the basis for a securitization.

	<b>Small Firms</b>	<b>Medium Firms</b>	<b>Large firms</b>
<b>PV of Earnings Differential</b>	\$165,124	\$296,001	\$550,823
<b>Assumed Exam Study Hours</b>	400	400	400
<b>Implied PV of Compensation per Study Hour</b>	\$413	\$740	\$1,377

#### **5. Outline for the Creation of Acers**

The authors propose the creation of a system whereby select accounting graduates are offered funding for a period of intensive certification exam preparation just following graduation. These funding arrangements would be relatively short-term. Because of the qualification of the borrowers, their future earnings streams can be easily and accurately estimated. Thus a pool of such loans fulfills the requirements for securitization. That is, the three major characteristics necessary for securitization are present. In this particular instance, one might most reasonably expect successful introduction of standardized short-term professional exam study loans which then in turn could be pooled. Direct securitization of the accountants' earnings streams for this purpose would most likely await main streaming of the private salary securitization concept. In either case, it is likely that some mechanism (either governmental or industry based) would be required to both introduce and oversee the loan program. With appropriate planning, securitization could follow.

#### **6. Conclusions**

This paper has discussed the potential use of securitization in solving the educational funding issue implied by current practices in recent graduate preparation for professional certification examinations in accounting. In the authors' assessment, the characteristics of the individuals involved make future earning streams and certification premiums reasonably estimable. Both direct securitization of future earnings stream premiums and securitization of loans secured by future earnings are discussed. Further development of the conceptualization is left for future research.

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