ADVISORY REPORT 98-1

January 16, 1998

TITLE IV FINANCIAL RESPONSIBILITY STANDARDS REVISED

New Rules Take Effect July 1, 1998

On November 25, more than a year after revisions to the financial responsibility standards were proposed, the Department of Education (ED) issued final regulations establishing a new methodology for determining the financial stability of institutions participating in the Title IV federal student financial assistance programs (Federal Register, page 62830). Significant provisions of the new rules, which are contained in a new Subpart L of the Student Assistance General Provisions under 34 CFR 668, include:

- The financial health of institutions will be assessed based on three ratios: primary reserve, equity, and net income. The equity ratio replaces the viability ratio in the proposed rules. An institution's raw scores will be converted to strength factors and combined into a composite score.
- Public institutions will not be evaluated using the ratio methodology. A public institution will be considered financially responsible if it submits a letter from an official of a state or other government entity confirming that the institution is public.
- Institutions with composite scores of 1.5 or above will be deemed financially responsible, while those below 1.0 will not be allowed to continue to participate in the Title IV programs without providing additional surety.
- Institutions with composite scores between 1.0 and 1.4 will be allowed to participate in Title IV under a new "zone alternative," under which they will be subject to special disbursement requirements and enhanced monitoring by ED. An institution may remain "in the zone" for up to three years.

The Federal Register notice also establishes a new method of disbursing federal student aid funds, cash monitoring, under the cash management regulations in Subpart K of Part 668. This provides an alternative disbursement method for institutions participating under the zone alternative or provisional certification that is less punitive and more flexible than the reimbursement method currently imposed on some institutions.

The new financial standards are effective for audited financial statements submitted to ED on or after July 1, 1998. A one-year transition rule will allow institutions that do not pass the new test to show that they would have been considered financially responsible under the current rules. The transition rule may only be used for fiscal years that began between July 1, 1997, and June 30, 1998.

ED delayed issuing final rules in 1996 at the urging of the higher education community, which raised a number of concerns about the methodology proposed in a notice of proposed rulemaking (NPRM) published last fall (September 26, 1996, Federal Register, page 49552).

The comment period on the proposed regulations was reopened and extended twice. ED received more than 850 comments before the final April 14 deadline. The extended comment period was open for more than 200 days, a considerable improvement over the original 45-day window. NACUBO Special Action Report 96-3 (October 4, 1996) included the NPRM. A Public Policy Alert (March 24, 1997) provided an update on alternatives under consideration by ED in the spring.

In a process that NACUBO hopes will serve as a model for future rulemaking on important or controversial issues, ED consulted extensively with members of the higher education community, the department's contractor, KPMG Peat Marwick, and others. NACUBO and other associations participated in a series of meetings during the winter and spring.

The final rules differ in several ways from the regulations proposed in September 1996. Significant changes include:

- replacing the viability ratio with the equity ratio;
revising the way in which strength factors are calculated to provide a continuum rather than integer steps;

- eliminating the assumption that financial ratios for independent institutions would show significant increases after adoption of new accounting standards;
- extending from one to three years the time for institutions with marginal composite scores to improve;
- eliminating the requirement that individuals with substantial control over an institution, including top executives and trustees, submit personal financial guarantees in some instances; and
- exempting public institutions from the financial ratio analysis.

This report provides an overview of the new financial responsibility standards for independent nonprofit institutions. (Separate criteria for hospitals are not included in the final rule; nonprofit hospitals are covered under the same standards as nonprofit institutions.) Because public institutions are not subject to most of the provisions in the rule, a separate and shorter report is being mailed to public institutions. Both reports are also available on NACUBO’s Web site.

The final regulations, including Appendix G which details the ratio methodology for nonprofit institutions, and the general explanation of the new financial responsibility standards in the preamble of the Federal Register notice are included at the end of this report. Due to the length of the Federal Register notice, however, ED’s detailed response to comments submitted on the proposed regulations and the discussion of the economic impact of the regulations on small entities are not reprinted here. A link to the entire notice is provided on NACUBO’s Web site.

Background

The Higher Education Amendments of 1992 required ED to develop financial responsibility standards for institutions taking into account operating losses, net worth, operating fund deficits, and asset-to-liability ratios. The current regulations (§668.15), adopted in 1994 and amended in 1995, set specific standards for liquidity, net worth, and profitability. To participate in the Title IV programs, an institution must meet the minimum threshold set for each of these measures, as well as a number of other criteria.

Neither ED nor the higher education community has been satisfied with the adequacy of the current measures of financial health to fairly identify institutions that pose a financial risk to Title IV funds. For instance, some institutions have failed to meet the 1:1 acid-test ratio requirement because only assets identified as cash and cash equivalents on the institution’s financial statements are counted. Institutions that few would consider a risk to Title IV funds have been forced to provide costly letters of credit or to accept provisional certification. On the other hand, ED has been concerned that institutions with financial problems are able to pass the current standards.

ED cites four reasons for revising the current standards:

1. A broader measure that reflects the overall financial condition of an institution is needed.
2. An approach that can evaluate the relative financial health of institutions would allow ED to more closely tie its gatekeeping and oversight efforts to the risk posed by institutions at different levels.
3. The standards do not adequately address the different accounting, financial, and operating characteristics that exist between proprietary and nonprofit institutions.
4. Rather than establish independent tests of an institution’s financial health, the standards should rely on a blended test so that strengths in one area can offset weaknesses in another.

In 1995, ED contracted with KPMG Peat Marwick, well-known for its work on ratio analysis in higher education, to develop a methodology that ED could use to better judge the financial health of institutions participating in the Title IV programs. Several business officers recommended by NACUBO served as members of a review panel for the KPMG project. The ratio analysis methodology proposed by ED in September 1996, and modified in the final regulations, is based on the results of the KPMG effort. KPMG’s final report on its work with ED is available on the ED Web site at http://www.ed.gov/offices/OPE/PPI/finanrep.html or on NACUBO’s Web site at http://www.nacubo.org. The KPMG report includes additional explanation of the ratio methodology. The results of its analysis of the financial statements of 395 nonprofit institutions and more than 500 proprietary institutions are provided, including distributions for the ratios.
Overview of the Methodology

The methodology adopted in the final regulations is similar to that proposed last year, with several refinements. The methodology is based on three ratios—primary reserve, equity, and net income—that measure different aspects of financial health. All are designed to be calculated based on information readily available from standard financial statements. It is important to note that institutions are not required to calculate the ratios or the composite score. ED will perform the calculations based on the institution’s audited financial statements.

Several mathematical steps are required to combine an institution’s ratio results into a composite score. Because the raw ratio results for the different ratios are not comparable, they need to be converted to strength factor scores to enable comparison. Then, because each ratio is not of equal importance, and to account for differences between proprietary and nonprofit institutions, the strength factor scores must be appropriately weighted. Following are the four steps of the methodology:

- Determine the value of each ratio;
- Calculate a strength factor score for each ratio using the appropriate algorithm;
- Calculate a weighted score for each ratio by multiplying the strength factor score by its corresponding weighting percentage; and
- Add the weighted scores to arrive at the composite score.

Details of the calculation of the composite score for nonprofit institutions are provided in Appendix G to the regulation, on page 62885 of the Federal Register notice. Table 1 on page 4 summarizes the factors needed to calculate the composite score for a nonprofit institution.

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Definition</th>
<th>Strength Factor Algorithm</th>
<th>Weighting Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary Reserve</td>
<td>expendable net assets</td>
<td>primary reserve x 10</td>
<td>40 %</td>
</tr>
<tr>
<td></td>
<td>total expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity</td>
<td>modified net assets</td>
<td>equity x 6</td>
<td>40 %</td>
</tr>
<tr>
<td></td>
<td>modified assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>if net income is negative</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1 + (25 x net income)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Income</td>
<td>change in unrestricted net assets</td>
<td>strength factor score = 1</td>
<td>20 %</td>
</tr>
<tr>
<td></td>
<td>total unrestricted revenue</td>
<td>if net income = 0:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>strength factor score = 1</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>if net income is positive:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>1 + (50 x net income)</td>
<td></td>
</tr>
</tbody>
</table>

**Expendable net assets** equals unrestricted net assets

plus temporarily restricted net assets

less annuities, term endowments, and life income funds that are temporarily restricted

less intangible assets

less net property, plant and equipment [net of accumulated depreciation, including capitalized lease assets]

plus post-employment and retirement liabilities

plus all debt obtained for long-term purposes [includes the short-term portion of the debt, up to the amount of net property, plant and equipment]

**Total expenses** taken from financial statements

**Modified net assets** equals unrestricted net assets

plus temporarily restricted net assets

plus permanently restricted net assets

less intangible assets

less unsecured related-party receivables

**Modified assets** equals total assets

less intangible assets

less unsecured related-party receivables

**Ratios.** Each ratio, its definition, and what it is intended to measure are discussed below. Charts 1 through 3 show the distribution of the results for each ratio for the 395 nonprofit institutions in the sample used by KPMG in its analysis. The sample, which represents about 18 percent of the nonprofit institutions that participate in Title IV, consists of those institutions...
whose financial statements under FASB 116 and 117 were available to ED by December 31, 1996.

**Primary Reserve Ratio.** The primary reserve ratio is defined as expendable net assets divided by total expenses. It measures an institution's expendable resources in relation to its overall operating size. According to ED, the primary reserve ratio measures "whether an institution has financial resources sufficient to support its mission—that is, whether the institution has (1) sufficient financial reserves to meet current and future operating commitments, and (2) sufficient flexibility in those reserves to meet changes in its programs, educational activities, and spending patterns. Thus, the Primary Reserve ratio provides a measure of two of the fundamental elements of financial health—financial viability and liquidity."

A provision included in the NPRM that would have found an institution not financially responsible if it had a negative primary reserve ratio was dropped in the final regulations. ED cites the counterbalancing effects of the equity ratio in measuring other capital resources available to the institution, which might mitigate the effects of a negative primary reserve ratio.

In another change from the proposed regulations, expendable net assets (the numerator of the primary reserve ratio) have been redefined. The institution’s post-retirement benefits obligation is excluded (i.e., the post-employment and retirement liabilities are added to net assets). NACUBO recommended this modification.

**Equity Ratio.** The equity ratio is defined as modified net assets divided by modified assets. The equity ratio measures the amount of resources that are financed by owners' investments, contributions, or accumulated earnings. According to ED, it measures an institution's capital resources, ability to borrow, and financial viability.

Unlike the primary reserve ratio, which looks at expendable net assets, the equity ratio takes into account fixed assets and permanently restricted endowment funds. ED notes in the discussion that the strength factor scores were not adjusted to account for the inclusion of endowments. This means that while institutions with sizable endowments will benefit, institutions with little or no endowments will not be hurt.

The equity ratio has been introduced in the final regulations as a replacement for the viability ratio. The viability ratio was criticized because it used long-term debt as a denominator; therefore, it could not be calculated for institutions that carried no debt. Additional analysis by KPMG during the extended comment period showed that 13 percent of the nonprofit institutions in its sample had no long-term debt. There was also concern that use of the viability ratio discouraged investment in physical assets.

**Net Income Ratio.** The net income ratio measures an institution’s profitability or ability to operate within its means for the year. It is defined as change in unrestricted net assets over total unrestricted revenue. According to ED, an institution "must generate surpluses to build reserves for future program initiatives and to increase its margin against adversity." However, recognizing that this surplus is not always possible, the strength factor scores are set so that an institution will get some credit toward the composite score even if it incurs a small loss. ED further notes that KPMG's analysis indicated that approximately 4 percent of expenses at nonprofit institutions are attributable to noncash items such as depreciation.

**Strength Factor Scores.** For the ratio scores to be comparable, an institution's raw score is translated into a strength factor score. The strength factor scores can range from –1 to 3 and are designed to reflect the degree to which an institution demonstrates strength or weakness in the elements measured by the ratios. According to ED, the scores "enable the Department to assess the extent to which an institution has the financial resources to:

1. Replace existing technology with newer technology;
2. Replace physical capital that wears out over time;
3. Recruit, retain, and re-train faculty and staff (human capital); and
4. Develop new programs."

The method by which strength factors are assigned has been changed in the final regulations. In the initial proposal, only integer values were used for strength factors, which were assigned by using a conversion table (e.g., if an institution's primary reserve score was between .50 and .99, its strength factor score was 3). This method magnified small differences between raw
scores at the edges of each range, with very small differences in raw scores resulting in significant differences in strength factor scores. To remedy this problem in the final regulations, ED has chosen to use linear equations to convert raw scores to strength factor scores. Because strength factors no longer have to be integers, the entire range of scores along the scale is used.

The algorithms were developed so that the strength factors correspond to certain judgments about institutional financial health. A strength factor of 0 is the point at which an institution demonstrates no strength for that ratio. A strength factor of 1 indicates the point at which an institution begins to demonstrate a minimal level of strength, and a factor of 3 shows relative strength. Table 2, below, gives ED's interpretation of various points along the range of strength factor scores and illustrates the raw ratio scores that correspond to each level. Actual strength factor scores could fall at any point along the scale from –1 to 3. By definition, any strength factor score that is less than –1 will equal –1; any score above 3 will equal 3.

<table>
<thead>
<tr>
<th>Strength Factor Score</th>
<th>Interpretation</th>
<th>Primary Reserve</th>
<th>Equity</th>
<th>Net Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>-1.0</td>
<td>liabilities exceed resources</td>
<td>–0.10</td>
<td>–0.167</td>
<td>–0.08</td>
</tr>
<tr>
<td>0.0</td>
<td>no demonstrable net resources</td>
<td>0.00</td>
<td>0.00</td>
<td>–0.04</td>
</tr>
<tr>
<td>1.0</td>
<td>minimal resources, but not enough for clear financial health</td>
<td>0.10</td>
<td>0.167</td>
<td>0.00</td>
</tr>
<tr>
<td>1.5</td>
<td>minimal level of resources to indicate financial health</td>
<td>0.15</td>
<td>0.250</td>
<td>0.01</td>
</tr>
<tr>
<td>3.0</td>
<td>clearly financially healthy on that resource</td>
<td>0.30</td>
<td>0.500</td>
<td>0.04</td>
</tr>
</tbody>
</table>

Source: U.S. Department of Education

The distinctions in the proposed regulations between independent institutions that had adopted the Financial Accounting Standards Board (FASB) Statements 116 and 117 and those that had not have been dropped in the final regulations. This revision is partly a question of timing, since most institutions have now adopted the new standards. ED has also acknowledged, in response to concerns raised by many commenters, that the assumptions that had been made about the impact of FASB 116 and 117 on an institution's financial statements were not confirmed by additional analysis of financial statements of a wider sample of institutions. Therefore, the methodology does not assume any changes in the relative ratio results for institutions that have adopted the new standards.

Weighting. The three ratios are not deemed equally important in measuring the financial health of institutions for the purposes of Title IV. In calculating the composite score, therefore, each ratio is assigned a weighting percentage. Weighting also allows differences between the for-profit and nonprofit sectors of higher education to be acknowledged so that even though the ratios are the same for all institutions, they are weighted differently. For nonprofit institutions, the primary reserve ratio and the equity ratio each account for 40 percent of the composite score. The net income ratio is 20 percent.

These weights have been altered from those in the proposed regulations. The primary reserve ratio is weighted less heavily, while the weighting factor for the net income ratio has increased. Some commenters were concerned that the heavy emphasis on expendable net assets measured by the primary reserve ratio would discourage internal investment in non-expendable assets. ED agreed, and lowered the weighting of the primary reserve ratio from 55 percent to 40 percent. The increased emphasis on the net income ratio gives institutions more credit for strong operating performance, while still acknowledging that generating operating surpluses is not an objective of many nonprofit institutions.

Composite Score. The preceding calculations are combined into the institution's "composite score," which is supposed to reflect the institution's overall financial health. It is the sum of the results of multiplying the strength factors for each ratio by the appropriate weighting percentage. The result is rounded to the nearest tenth, or one digit after the decimal point.
An institution with a composite score of 1.5 or higher will be considered financially responsible, providing it meets the other requirements of Subpart L. According to ED, a composite score of 1.5 characterizes "an institution that has some margin against adversity, is funding its historical capital replacement costs, and has the resources to provide funding for some investment in human and physical capital. However, the institution has no excess funds to support new program initiatives or major infrastructure upgrades."

An institution with a composite score between 1.0 and 1.4 is eligible to participate in the Title IV programs under a new option, known as the "zone alternative." An institution at this level, according to ED, "has some margin against adversity, is funding its historical capital replacement costs, and has the resources to provide funding for some investment in human and physical capital. However, the institution has no excess funds to support new program initiatives or major infrastructure upgrades." An institution may remain in the zone—where it will be subject to additional monitoring requirements—for no more than three consecutive years. The zone alternative is discussed below.

Institutions with composite scores of less than 1.0 fail the composite score test and will not be considered financially responsible unless they qualify under one of the alternatives. Generally, an institution would have to provide a letter of credit for 50 percent of the institution's prior year Title IV expenditures or accept provisional certification and provide a 10 percent letter of credit to continue to participate in the Title IV programs.

The composite scores necessary for an institution to be considered financially responsible were lowered in the final regulations. This change partly reflects a decision by ED to measure the financial health of an institution over a shorter period of 12-18 months, rather than the 3-4 years used in developing the proposed methodology. It is also the result of ED's decision to accept greater risk to avoid unnecessarily penalizing institutions.

Overview of the New Regulations

Part 668, Subpart K—Cash Management

§668.162 Requesting funds. The cash management regulations are modified to provide a new alternative for disbursing federal funds to certain institutions. Cash monitoring is intended to provide greater safeguards to the federal government than the advance method used by most institutions that are in good standing, but it is not as burdensome as the reimbursement method currently required for provisionally certified institutions. The new method is intended for institutions whose composite scores fall in the zone between 1.0 and 1.4 and may also be used for provisionally certified institutions.

Under this method, an institution may not draw down Title IV funds in advance. The institution must first make disbursements to students and parents and then submit a request for funds to ED. There are two options for institutions seeking reimbursement. Funds may be requested (1) in the same way that they are under the advance method, i.e., the institution draws down Title IV funds itself (but only for the amount that has been disbursed) or (2) under the provisions of the reimbursement payment method, but with modifications to the documentation requirements or review procedures. The options and flexibility in the cash monitoring method are for ED to exercise, not the institution. This is deliberate to allow the case management personnel at ED's new Institutional Participation and Oversight Service (IPOS) to tailor requirements to the particular situation.

Subpart L—Financial Responsibility

§668.171 General. The four primary criteria for determining if an institution is financially responsible are listed in §668.171(b):

1. The institution has a composite score for its equity, primary reserve, and net income ratios of at least 1.5.
2. The institution has sufficient cash reserves to make required refunds.
3. The institution is current in its debt payments.
4. The institution is meeting all of its financial obligations.

The provisions under (b)(2), (3), and (4) are the same as in the current regulations.

Paragraph (c) sets forth an exemption that will allow public institutions to be considered financially responsible if confirmation of their status is provided. This should resolve a number of issues that surfaced regarding both the current and the proposed financial responsibility standards for public institutions. Even if an institution meets the general standards of financial
responsibility in paragraph (b), it will not be considered financially responsible under some circumstances. First, if the institution’s audit included an adverse, qualified, or disclaimed opinion, or if the auditor expressed doubt that the institution would continue as a going concern, the institution will not be considered financially responsible. In a change from the current regulations, the Secretary is given leeway to determine that a qualified or disclaimed opinion does not have a significant bearing on the institution’s financial condition and will not affect its status.

Second, the institution must have not run foul of the past performance provisions in §668.174(a) and (b)(1). These rules cover problems with past limitation, suspension, or termination proceedings; timeliness of audits; problems identified in program reviews or audits; or affiliations with persons who owe Title IV liabilities.

§668.172 Financial ratios. Section 668.172 briefly defines the ratios and the steps involved in calculating an institution’s composite score. Details are provided in Appendix F (proprietary schools) and Appendix G (nonprofit institutions). Third-party servicers which were covered in the proposed rules, are not covered specifically by the final regulations. In the preamble, ED notes that financial standards designed for third-party servicers will be developed in the future.

Paragraph (c) excludes a number of items from the calculation of the ratios, including:

- extraordinary gains or losses
- income or losses from discontinued operations
- prior period adjustments
- cumulative effect of changes in accounting principles
- effect of changes in accounting estimates
- unsecured or uncollateralized related-party receivables
- intangible assets
- federal funds provided under an HEA program, if disclosed in notes to the financial statements

Related-party receivables are excluded from the calculation of the equity ratio. In its discussion of comments, ED notes that representatives of nonprofit institutions objected to this, apparently referring to pledges from churches or other benefactors. Pledges that meet the requirements under FASB 116 to be recorded as an economic resource in an institution’s audited financial statements will be included as assets in calculating the ratios. According to ED, related-party receivables are most often encountered in the proprietary sector.

Grant funds received for support of HEA programs that are reported as expenses in an institution’s statement of activities may be excluded from the ratio calculations. ED specifically mentions programs to strengthen institutions or expand access to higher education as types of sponsored programs that should not cause an institution to fail the composite score test. This calculation will only be made, however, if the institution otherwise has a composite score of less than 1.5 and discloses the amount of such grants in a note to its financial statements or in a separate attestation. ED notes in its discussion of the economic impact of the revised rules that it is significantly less expensive to have this information included in a note to the financial statements, rather than engaging the auditor to prepare a separate attestation. Institutions may want to consider this when contracting with their auditors if exclusion of HEA grant funds may make a difference in their composite scores.

§668.175 Alternative standards and requirements. ED has pulled the provisions relating to alternatives for institutions that do not pass the general standards into §668.175.

Letter of Credit. The first alternative (paragraph (b) for new institutions and paragraph (c) for participating institutions) requires the institution to obtain a letter of credit for 50 percent of its Title IV funds to qualify as a financially responsible institution. This alternative is available to institutions that failed to meet the general standards under §668.171(b) or had a problem with the audit opinion mentioned in (d)(1). It is apparently not available as an option for institutions that fail the past performance provisions in §668.174.

In considering the economic impact of the rule, ED estimates the cost of a $1 million letter of credit at between $7,500 and
$12,500 in fees with an opportunity cost of about $125,000 on the required collateral. ED notes in the preamble that institutions that do not meet the composite score test may find that it is less costly to take steps necessary to improve their score rather than use the letter of credit alternative repeatedly.

**Zone Alternative.** Institutions with composite scores between 1.0 and 1.4 are eligible for the new zone alternative. An institution may qualify as financially responsible under the zone alternative for no more than three consecutive years. After an institution achieves a 1.5 or higher composite score in one year, it would again be eligible for the zone alternative for another three years if its composite score subsequently fell below 1.5.

An institution that participates in Title IV under the zone alternative will be monitored more closely by ED and must comply with the following special requirements:

- **Disbursements.** The institution will be required to make disbursements to students and parents under the cash monitoring or reimbursement payment method. (See discussion of cash monitoring under §668.162 above.)
- **Reporting.** The institution must report, within 10 days, a number of events, including: an adverse action by its accrediting agency; any event that causes the institution to realize a contingent liability; any violation of a loan agreement; any failure to make a payment that results in a creditor filing suit against the institution; or any extraordinary losses.
- **Audits.** The institution may be required to submit its financial statements or compliance audits earlier than otherwise required. In the preamble, ED notes that this may be as soon as two months after the end of the fiscal year. (Note: ED cannot require an institution covered under Office of Management and Budget (OMB) Circular A-133 to submit audited financial statements earlier than the deadline in the circular; but unaudited financial statements could be requested.) Also, compliance with requirements under the zone alternative must be addressed in the institution's compliance audit.
- **Plans.** The institution may be required to provide information to ED about its current operations and future plans.

**Transition Year Alternative.** The new financial responsibility standards become effective for audited financial statements submitted on or after July 1, 1998. If an institution fails to achieve a composite score of at least 1.5, it may qualify under the transition year alternative as financially responsible under the current regulations for the institution’s fiscal year that began between July 1, 1997, and June 30, 1998, only.

An ED official has clarified that for cases in which an institution's audit for an earlier fiscal year is submitted on or after July 1, 1998, if the institution does not pass the new financial responsibility standards, its financial statements will also be judged against the current standards in §668.15. Institutions that file audited financial statements under OMB Circular A-133, which allows 13 months for submission, may submit financial statements for the previous fiscal year (FY 96-97) in July 1998 or later.

**Provisional Certification Alternative.** Provisional certification is the last alternative for institutions that are not financially responsible under the general standards in §668.171(b) or (d). An institution that fails due to the past performance criteria is eligible for provisional certification if it can show that the problem has been resolved. There are special rules under §668.175(g) for provisional certification for persons or entities that owe Title IV liabilities.

An institution may be provisionally certified for up to three consecutive years. The institution must:

- submit a letter of credit for at least 10 percent of the institution’s prior year Title IV funds;
- have been current on its debt payments and met all of its financial obligations for its last two fiscal years; and
- comply with the same disbursement and reporting requirements applicable for the zone alternative under §668.175(d)(2) and (3).

In the final rules, ED has modified its proposal to require owners or persons with substantial control (defined to include top executives and members of the board of trustees) to provide personal financial guarantees in order for institutions to qualify for provisional certification or other alternatives under some circumstances. The Secretary may require financial guarantees from the institution or persons with substantial control if he permits an institution to be provisionally certified again after the end of a previous period of provisional certification or in cases involving Title IV liabilities. The institution is, however, listed as one of the parties that can provide the guarantee (as current regulations allow).
For More Information

The entire November 25 Federal Register notice is available through GPOAccess. For further information and assistance with general questions, contact John Kolotos or Lloyd Horwich, U.S. Department of Education, 600 Independence Avenue, S.W., Room 3045, ROB-3, Washington, D.C. 20202, telephone 202-708-8242. For information regarding accounting and compliance issues, contact ED's Institutional Participation and Oversight Service (IPOS) Case Management Team for the state in which the institution is located. IPOS Case Management Team Contacts

- Boston Team, 617-223-9338 (covering Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont)
- New York City Team, 212-264-4022 (covering New Jersey, New York, Puerto Rico, and the Virgin Islands)
- Chicago Team, 312-886-8767 (covering Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin)
- Dallas Team, 214-880-3044 (covering Arkansas, Louisiana, New Mexico, Oklahoma, and Texas)
- Kansas City Team, 816-880-4053 (covering Iowa, Kansas, Kentucky, Missouri, Nebraska, and Tennessee)
- Denver Team, 303-844-3677 (covering Colorado, Montana, North Dakota, South Dakota, Utah, and Wyoming)
- San Francisco Team, 415-437-8276 (covering Arizona, California, Hawaii, Nevada, American Samoa, Guam, Federated States of Micronesia, Palau, Marshall Islands, and Northern Marianas)

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