

ADVISORY REPORT 98-2

January 16, 1998

PUBLIC INSTITUTIONS EXEMPT FROM RATIO ANALYSIS UNDER REVISED TITLE IV FINANCIAL RESPONSIBILITY STANDARDS

NEW! April 15: [ED instructions](#) on submitting letters from state or other government entity.

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New Rules Take Effect July 1, 1998

Public institutions will face no ratios, strength factors, or composite scores under final regulations issued by the Department of Education (ED) revising the financial responsibility standards for institutions participating in the Title IV federal student financial assistance programs (see November 25, 1997, *Federal Register*, page 62830). A public institution will be considered financially responsible under the new Subpart L of the Student Assistance General Provisions under 34 CFR Part 668 if it provides a letter from the appropriate government entity confirming that it is a public institution. The only exception is if the institution runs afoul of certain indices of past difficulties in administering the Title IV programs. The new rules are effective July 1, 1998.

Regulations proposed by ED in the fall of 1996 would have measured the financial health of public institutions using a methodology based on three ratios—primary reserve, viability, and net income (see September 26, 1996, *Federal Register*, page 49552). Numerous comments arguing for an exemption for public institutions were filed by public institutions and their representatives, including NACUBO, in response to the notice of proposed rulemaking.

This report addresses only the requirements under the financial responsibility standards applicable to public institutions. [Advisory Report 98-1](#) (January 13, 1998) details the ratio methodology and other provisions that apply to nonprofit institutions. Each report is being mailed to the appropriate segment of the NACUBO membership.

Background

The Higher Education Amendments of 1992 required ED to develop financial responsibility standards for institutions. An exception was provided under Section 498(c)(3)(B) for public institutions whose liabilities are "backed by the full faith and credit of a State, or by an equivalent government entity." Implementing this exception has been problematic because probably less than half of the public institutions would meet a literal interpretation of the "full faith and credit" criteria.

Under the current regulations, released in 1994, a public institution is considered financially responsible under §668.15(b)(9) if it:

0. has its liabilities backed by the full faith and credit of a state or equivalent governmental entity;
0. has a positive current unrestricted fund balance;
0. has a positive unrestricted current fund in the state's Higher Education Fund;
0. submits a statement from the state auditor general that the institution has sufficient

resources to meet its financial obligations; or

0. demonstrates that it has a bond rating at the second highest level or above.

Revised Regulations

Under ED's 1996 proposal, financial statements of public institutions that did not meet a "full faith and credit" alternative would have been subject to the ratio methodology. Three ratios—primary reserve, viability, and net income—were defined for public institutions along with the outcomes necessary to be considered financially responsible. Institutions with a negative primary reserve ratio or a composite score of less than 1.75 would have failed the test.

Commenters on the proposed regulations noted a number of difficulties inherent to attempts to analyze the financial statements of public institutions in this manner. Reasons cited for not applying the ratio methodology to public institutions included:

- o low risk of precipitous closure of public institutions
- o amount of official oversight and public scrutiny to which these institutions are subject
- o upcoming changes in the Governmental Accounting Standards Board reporting model for colleges and universities
- o variations in the accounting practices from state to state and in what assets and liabilities are carried on the institution's financial statements
- o tensions between the methodology's interest in profits and fund balances and state public policy goals

In the end, ED decided not to use the ratio methodology to determine the financial responsibility of public institutions, opting instead to take a broader view of the full faith and credit alternative in the statute. In the preamble of the *Federal Register* notice,

ED cites two primary reasons for this decision:

First, these institutions are subject to more public oversight and scrutiny than private non-profit and proprietary institutions. The Secretary believes that it is the responsibility of the State or responsible government entity to make available the resources necessary for those institutions to provide the education and services expected by students who enroll at those institutions and the residents of the State or locality whose funds support the institutions. Second, the legal and financial relationships between public institutions and their respective State or local governments vary widely, impacting in different ways the assets and liabilities reported on those institutions' financial statements. Thus, the ratio methodology would not treat all public institutions equitably.

ED also notes that the approach used to implement the full faith and credit alternative in the revised regulations was chosen to "eliminate technical and other problems experienced by public institutions in demonstrating their compliance with this provision under the current regulations."

Only a few paragraphs of the revised Subpart L pertain to public institutions. These paragraphs are discussed below.

§668.171 General. The general requirement for public institutions is stated in §668.171(c):

(c) *Public institutions.* The Secretary considers a public institution to be financially responsible if the institution—

- (1) (i) Notifies the Secretary that it is designated as a public institution by the State, local or municipal government entity, tribal authority, or other government entity that has the legal authority to make that designation; and

(ii) Provides a letter from an official of that State or other government entity confirming that the institution is a public institution; and

(2) Is not in violation of any past performance requirement under §668.174.

According to an ED official, these letters—one from the institution and one from a government official—should be submitted to the Institutional Participation and Oversight Service (IPOS) case management team for the state in which the institution is located. The department has not specified which government agency needs to confirm the institution's status, but has indicated a willingness to be flexible to accommodate state and local variations.

§668.173 Refund Reserve Standards. The refund reserve requirements have not changed substantively. An institution is presumed to have sufficient cash reserves to make refunds if it satisfies the requirements of a public institution under §668.171(c)(1).

§668.174 Past Performance. A public institution will only be considered financially responsible under §668.171(c) if it has not had certain problems in its past administration of Title IV funds. These factors, which are found in the current regulations at §668.15(c), are delineated in §668.174(a) as follows:

(a) *Past performance of an institution.* An institution is not financially responsible if the institution—

0. Has been limited, suspended, terminated, or entered into a settlement agreement to resolve a limitation, suspension, or termination action initiated by the Secretary or a guaranty agency, as defined in 34 CFR part 682, within the preceding five years;
0. In either of its two most recent compliance audits had an audit finding, or in a report issued by the Secretary had a program review finding for its current fiscal year or either of its preceding two fiscal years, that resulted in the institution's being required to repay an amount greater than 5 percent of the funds that the institution received under the title IV, HEA programs during the year covered by that audit or program review;
0. Has been cited during the preceding five years for failure to submit in a timely fashion acceptable compliance and financial statement audits required under this part, or acceptable audit reports required under the individual title IV, HEA program regulations; or
0. Has failed to resolve satisfactorily any compliance problems identified in audit or program review reports based upon a final decision of the Secretary issued pursuant to subpart G or H of this part.

Paragraph (b) concerns persons with substantial control over the institution (trustees or executive officers) who owe liabilities for violations of Title IV program requirements.

§668.175 Alternative Standards and Requirements. The only alternative available to a public institution that is determined to be not financially responsible because of the past performance criteria is provisional certification under §668.175(f). To be eligible for provisional certification, the institution must first show that it has satisfied or resolved the condition that caused it to violate §668.174. An institution can be provisionally certified by ED for no more than three consecutive years. During this period, the institution will be required to:

- o submit a letter of credit for 10 percent of its Title IV funds;
- o demonstrate that it is current on its debt payments and met its financial obligations for the last two years; and
- o comply with certain provisions of the zone alternative under §668.175(d)(2) and (3) concerning disbursement of Title IV funds and special reporting obligations.

For More Information

The entire November 25 *Federal Register* notice is available through NACUBO's Web site at <http://www.nacubo.org>.

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 IPOS case management team for the state in which the institution is located. Phone numbers are available in the *Federal Register* notice or on ED's Web site at <http://www.ed.gov/offices/OPE/News/opelist.html#two>.

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