

NACUBO Town Hall - Financial Responsibility Rules and Clarifications
Questions Posed: November 30, 2020

The following questions and answers contain questions raised and covered during NACUBO's November 30 Townhall program: [Financial Responsibility Rules and Clarifications](#). Additional information is also available on in NACUBO's [Financial Responsibility Accounting Tutorials](#).

1. *Question: We took advantage of the six-month extension to submit our fiscal year 2019 Uniform Guidance report and eZ-Audit form. Our fiscal year end is June 30; the original deadline was March 31, 2020, but with the extension we submitted after July 1, 2020. Our submission was rejected because it did not include the supplemental schedule. Do we need to reopen the fiscal year 2019 Uniform Guidance report, or can we issue a separate report with the required information?*

Answer: The July 1, 2020 date is a threshold; audited financial statements submitted after July 1, 2020, are subject to the new regulation. The regulation indicates that a Financial Responsibility Supplemental Schedule (FRSS) is submitted as part of an institution's audited financial statements. Further, each item in the FRSS must have a reference to the balance sheet, income statement, or notes to the financial statements. In order to meet the regulatory requirements, institutions may need to submit a special purpose audit to the Department of Education for FY19 because the FRSS must be associated with audited financial statements and notes to the financial statements. Institutions in this situation should discuss options with their auditors.

2. *Question: Where in the Uniform Guidance report should the Supplemental Schedule and accompanying disclosures appear? Are they appended to the Schedule of Expenditures on Federal Awards (SEFA), or should they appear separately?*

Answer: **The Supplemental Schedule (FRSS) is a separate schedule and not related at all to the SEFA.** NACUBO suggests adding a section to the Uniform Guidance (UG) audit report titled "Department of Education Requirements" or "Financial Responsibility Requirements," which includes the FRSS in the institution's desired format. The FRSS can contain optional notes or schedules that may be helpful to ED analysts (for example, to assist with cross-walking between the FRSS and eZ-Audit, if the FRSS is not in eZ-Audit format), but this is not required.

In addition, a new note to the financial statements must be added if the non-GAAP items on the FRSS (for example, pre-and post-implementation debt, PP&E, or lease asset and liability amounts), or any other amounts on the FRSS do not directly appear either on the face or in the notes of the general purpose audited financial statements. The additional note can be titled "Financial Responsibility," "Department of Education," "Title IV Participation," or something similar.

More information on the crosswalk and the disclosures can be found [here](#).

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3. *Question: Where in the regulation is the requirement for including a cross-reference from the Supplemental Schedule to the face of the financial statements or notes to the financial statements?*

Answer: Page 49,875 of the regulation indicates that Section 498 (c)(5) of the Higher Education Act requires the Department of Education to use the audited financial statements to determine whether an institution is financially responsible. Further, because the Supplemental Schedule is not considered part of the financial statements, the department cannot rely on the Supplemental Schedule to assess financial responsibility. Consequently, a note will need to be included only when the required information is not readily identifiable in any other part of the audited financial statements.

The Department wants to rely on the audited financial statements. Because notes to the financial statements are an integral part of the financial statements—and the auditor’s opinion addresses the statement and notes—any additional disclosures to satisfy values on the Supplemental Schedule must be included in the notes to the financial statements.

4. *Question: Do the financial statement line items need to be numbered and then the Supplemental Schedule numbered? Can there be a note to the supplemental schedule with any numbers not in the financial statements? Isn't the supplemental schedule audited and thus the note, too?*

Answer: Appendix B in the regulation is illustrative. The Supplemental Schedule (FRSS) does not have to follow the format in Appendix B. The institution owns the FRSS and can use any format it prefers, adding and deleting lines as appropriate, or following the format of the eZ-Audit templates. Therefore, institutions do not have to provide line numbers on their financial statement or FRSS, although they can certainly choose to.

Although the Supplemental Schedule is audited, per the response to Question 3, the regulation requires that all relevant items needed to assess financial responsibility be included on the face of the financial statements or in the notes to the financial statements. The regulation requires that the FRSS cross-reference to specific values on the face of the financial statements or notes to the financial statements.

5. *Question: When reporting the debt obtained for long-term purposes (DOLP), should the amount reported reflect any unamortized debt issuance costs (a reduction of DOLP), and/or premiums or discounts upon issuance of the debt?*

Answer: Pre-implementation debt is the ending balance of debt reflected in the institution’s previously accepted audited financial statements up to the total amount of property, plant, and equipment (PP&E) in those audited financial statements—and reduced by payments or other activity since those financial statements were submitted. Allowable pre-implementation debt should simply be a roll-forward of what was previously allowable (including any known

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adjustments by ED), and included payment and other activity reductions up to allowable net pre-implementation PP&E.

Concerning post-implementation debt, the regulation does not directly address premiums, discounts, and issuance costs. Rather, the regulation states that post-implementation debt must be associated with acquired PP&E. Therefore, NACUBO advises a conservative approach—meaning, because premiums and discounts affect the proceeds received and the interest expense but have no effect on the amount of debt to be paid back, premiums or discounts would not be included in the amount reported as DOLP.

ED's Q&A document, Question LD9, addresses issuance costs related to a refinance. According to the answer, issuance costs are amortized over the life of the debt and the amount of issuance costs would not be considered long-term debt when calculating the composite score.

Finally, according to the regulation, the amount reported as DOLP (pre-and post-implementation) must agree with the audited financial statements (face or notes to the financial statements). The regulation (p. 49873) requires that each institution disclose the debt terms, beginning balance, actual payments, repayment schedules, ending balance, and any other changes in its debt, including lines of credit for both pre-and post-implementation DOLP.

6. *Question: Concerning a debt refinance, what about a taxable advanced refunding, whereby the amount of outstanding debt increased due to the prefunding of interest due that was placed in escrow?*

Answer: Page 49873 of the regulation states that any refinancing or renegotiated debt cannot increase the amount of debt associated with previously purchased PP&E. No pre-implementation debt required to be disclosed can increase.

A Department of Education Q&A released in April and updated August 2020 addresses refinancings. Question LTD 3 introduces the term “proceeds” from a refinancing and indicates that when refinanced proceeds exceed the balance of the originally qualified pre-implementation debt, the new debt would be considered post-implementation and, as such, would have to have an associated PP&E acquisition.

NACUBO has asked the Department of Education to reconsider this answer. When debt is refinanced at a premium, proceeds containing the premium can exceed the value of the original debt issue, thus disqualifying the debt even though par value may not have increased. NACUBO believes that institutions should use par value as the benchmark to determine if the refinance exceeds previously allowed debt—because this is consistent with language on page 49876: “any refinancing or renegotiated debt cannot increase the amount of the debt.” Premiums or pre-funded interest in escrow do not have to be paid back—and should not disqualify previously allowable debt if the par value after refinance has not increased the amount of the debt.

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7. *Question: Is it advisable for institutions to include the totals for the numerators and denominators of the ratios in the supplemental schedule? Should they also show the calculation of the composite score?*

Answer: The regulations do not require calculating and displaying the totals for the ratios, corresponding numerators and denominators, or the composite score. However, institutions are not precluded from including this information. Although including these calculations, ratios, and composite score as additional Supplemental Schedule items or disclosures may be useful for financial statement readers, institutions should check with their auditors. However, the only official calculation of the ratios and composite score is the one performed by ED.

NACUBO advises institutions to derive ratio results and the composite score for internal use, to ensure c they know where they stand before ED makes composite scores publicly available.

8. *Question: Although capitalized and Right-of-Use (ROU) lease liabilities are included with debt obtained for long-term purposes (DOLP) when calculating expendable net assets in the primary reserve ratio, is it acceptable to include (report) ROU liabilities – after implementing ASU 2016-02 and assuming no transition grandfathering election is made – as post-implementation lease liabilities? Reporting in this way would more easily segregate the ROU liabilities from all other pre-and post-implementation DOLP required amounts.*

Answer: Yes, ED will accept ROU liabilities – and ROU assets – on the eZ-Audit input lines titled “Post-implementation right-of-use lease liabilities” and “Lease right-of-use assets, post-implementation,” respectively. These labels can also be used for the Supplemental Schedule. If there is no amount on the “pre-implementation” asset and liabilities lines, ED will assume that the grandfathering election was not made. Reporting in this way may ease tracking burden between allowable pre-and post-implementation DOLP and PP&E.