August 30, 2018

Mr. Jean-Didier Gaina  
U.S. Department of Education  
400 Maryland Avenue, SW  
Mail Stop 294-20  
Washington, DC 20202

RE: Docket ID: ED-2018-OPE-0027

Dear Mr. Gaina:

The National Association of College and University Business Officers (NACUBO) appreciates the opportunity to comment on the Department of Education’s (ED) notice of proposed rulemaking (NPRM) to establish a new federal standard and a process for determining whether a borrower has a defense to repayment on a loan based on an act or omission of a school, published in the Federal Register on July 31, 2018. NACUBO is also writing today on behalf the three undersigned associations.

NACUBO, founded in 1962, is a nonprofit professional organization representing chief administrative and financial officers at more than 1,900 colleges and universities across the country. NACUBO’s mission is to advance the economic vitality, business practices, and support of higher education institutions in pursuit of their missions.

NACUBO remains steadfast in its position that student borrowers should be protected from misleading, deceitful, and predatory practices of institutions. Students who may have been victims of fraud or were harmed by the sudden closure of an institution should not be left without recourse. Since 2016, NACUBO has supported ED’s goal to establish borrower defense standards and to define the evidence former and current students must provide to show that a college’s misconduct warrants debt relief. NACUBO also recognizes that the existing rules under the Higher Education Act borrower defense to repayment provision were underdeveloped and infrequently used.

While we believe that the recently proposed NPRM is an improvement in certain ways over previous rulemaking attempts, there are numerous areas within the proposed rulemaking that raise concern. NACUBO is particularly troubled by the curtailing of several student borrower protections as well as with components of the financial responsibility proposals, including definitions and calculations as put forth in the notice.

Our specific comments and concerns follow in greater detail.
Rights of Borrowers

NACUBO endorses the positions expressed by the American Council on Education (ACE) in its comment letter on this NPRM. We strenuously agree that the rule can be improved to truly provide a fair and balanced process for granting borrowers relief due to the sudden closure of, or fraud or misrepresentation by, their institution. NACUBO is particularly concerned with the elimination of affirmative defenses, claimant timelines, and the elimination of group claims.

Elimination of Affirmative Defenses

The Department has proposed two paths forward for the eligibility of borrower defense to repayment claims. One would eliminate the existing ability of borrowers to affirmatively bring claims before they have defaulted on their loan obligations. The other would preserve the right of borrowers to affirmatively bring claims prior to entering default but would raise the evidentiary standard for all borrowers.

Consistent with ACE’s position, NACUBO urges the Department to reconsider a regulatory regime that would both maintain the existing preponderance of the evidence standard and permit both affirmative and defensive claims to be made.

As outlined by the Harvard University Project on Predatory Student Lending in its comment letter to the Department on this issue, there is longstanding precedent of ED permitting affirmative claims. Given the many severe financial and potentially professional consequences incurred by borrowers who default on loan obligations, it would be unreasonable for the Department to make such a damaging event a condition of eligibility for borrower defense claims.

The preponderance of the evidence standard is one aspect of the existing borrower defense regulatory regime that has served both the Department and claimants well. It is an appropriate standard for the type of relief sought and, in conjunction with other claimant requirements, sufficiently thorough to satisfy ED’s evidentiary concerns. The proposal to impose a clear and convincing evidentiary standard in the event that the Department permits affirmative defenses needlessly creates additional burden on claimants without truly compelling justification; the Department is simultaneously proposing to redefine “misrepresentation” for claim purposes in such a way as would weed out many frivolous and unsubstantiated claims.

Claimant Timelines

While we appreciate the proposal’s provision that would allow borrowers 180 days following a school closure to file a closed school discharge claim, the related provision to disqualify students for a closed school discharge if they decline an orderly teach-out plan when offered one is concerning. We encourage ED to reconsider previous rulemaking attempts that would give students the option to accept a teach-out plan or have their loans discharged, with the understanding that students who did not re-enroll in another institution or transfer credits within three years would automatically have their federal loans forgiven.

Additionally, the proposal that does not permit borrowers to appeal a denied claim, even in light of new evidence, is overly broad. We agree that generally borrowers do not need to be permitted an appeal to a denied claim; however, there should be some flexibility for appeals in select cases where a claimant can show sufficiently compelling additional information. Without some consideration for unusual cases, there will undoubtedly be some student borrowers who are harmed.
Elimination of group claims

NACUBO appreciates the Department’s willingness to allow for claims to be made by individuals, but we are concerned by the proposal’s specification that group claims will not be permitted, even when there is evidence that entire groups of borrowers were similarly misled by the same institution. Previous rulemaking attempts allowed for group claims to be made and would have permitted the Department to include borrowers in a group claim even if they had not filled out an application, with the provision that borrowers be allowed to opt out of group claims should they so choose. We believe that group claims can streamline and hasten the borrower defense process for both borrowers and ED and would encourage the Department to reconsider the potential for group claims to be made.

Institutional Concerns

Triggering Events

NACUBO is overall very pleased that the Department significantly reduced the number of mandatory and discretionary triggering events from previous rulemaking efforts and tied the remaining triggers to identifiable and tangible criteria. We believe that the triggers applicable to nonprofit institutions are generally reasonable but do have some concerns with the discretionary triggers.

**Cohort Default Rate (CDR) Discretionary Trigger.** Cohort default rates are unrelated to an institution’s financial stability. There are already statutory sanctions in place for schools whose CDRs exceed certain limits. NACUBO does not believe that it is appropriate to include a discretionary trigger related to CDRs.

**Triggering Event Reporting Requirements.** NACUBO recommends a 30-day timeline for the reporting of required events. Various offices across the administration might be involved and have contemporaneous knowledge of these events, but the individuals dealing with an unrelated agency action, such as renegotiating debt, are unlikely to have an ED reporting deadline on the top of their minds. Those who are charged with maintaining compliance with ED regulations may be unlikely to learn about such actions, particularly at large, decentralized institutions.

Institutional Financial Responsibility

Regarding the changes to institutional financial responsibility, NACUBO finds this NPRM to be an improvement over the current regulation. We are, in large part, pleased with the Department’s attempts to correct known issues related to updates to Generally Accepted Accounting Principles (GAAP) since the original regulation was established and, specifically, in efforts to address two recent Financial Accounting Standards Board (FASB) Accounting Standards Updates (ASU) that are sweeping in nature: Leases (ASU 2016-02) and Not-for-Profit Financial Statements (ASU 2016-14).

During the negotiating process, efforts to address needed changes to financial responsibility were significantly enhanced by using a subcommittee of experts on matters of financial accounting and reporting, independent audit work, and institutional financial management.

However, we have concerns with some aspects of the Department’s proposals.

Our issues fall into the following categories:

1. **Definition of debt obtained for long-term purposes.**
I. Definition of debt obtained for long-term purposes

NACUBO is surprised, and disappointed, that ED proposed examining long-term debt beyond long-term lines of credit in the NPRM. NACUBO asks that this extension of requirements beyond long-term lines of credit be removed.

It is NACUBO’s understanding that the subcommittee’s scope of work included making recommendations for closing a loophole on the use of long-term lines of credit to manipulate composite scores. The genesis of the subcommittee’s charge was the 2017 GAO Report, “Education Should Address Oversight and Communication Gaps in Its Monitoring of the Financial Condition of Schools” (the GAO Report).

The definition proposed in the NPRM does not align with the subcommittee’s charge during negotiations (which was directly taken from the GAO Report), nor is it supported by GAO’s concluding paragraph (emphasis added):

Further, Education stated that the composite score’s vulnerability to manipulation is a factor to consider and address but does not in itself undermine its usefulness because any financial measure could be manipulated once the elements of the measure are known. However, the cases discussed in our report illustrate how the formula can incentivize schools to take on additional debt. While intentional manipulation of any formula is always a possibility, changes are needed to address this known weakness with the composite score formula that schools have actively exploited to manipulate their scores and avoid additional oversight.

ED’s charge to the subcommittee was solely to focus on institutions’ end-of-year line of credit use (draws) with repayment after audited financial statements were issued.

NACUBO understands that the subcommittee discussed two options: first, only allowing long-term lines of credit that are active for over 12 months, and second, allowing long-term lines of credit if the financing is used for property, plant, and equipment (PP&E) or other assets that are capitalized per GAAP. The subcommittee ultimately recommended that for long-term lines of credit to be allowed in the calculation of expendable net assets, the line(s) of credit would have to be separately identified on the Financial Responsibility Supplemental Schedule (Supplemental Schedule) with accompanying information that specifies the issue date, term, nature of capitalized amounts, and amounts capitalized.

Page 37279 of the NPRM notes that the Department has elected to mitigate the possible risk of manipulating the composite score by fundamentally changing the definition of all debt obtained for long-term purposes. While the GAO Report addresses the composite score’s vulnerability to manipulation and indicates that a few institutions take on long-term debt because these debts increase their composite score, it did not find extensive composite score manipulation by most higher education institutions.

The NPRM effectively repeals the guidance of a 2003 “Dear Colleague Letter” (DCL) on this matter. NACUBO recommends maintaining the 2003 DCL guidance. Should ED disagree, we respectfully ask that the Department consider either requiring long-term debt to be collateralized by specific PP&E or
prospective modification to the 2003 DCL guidance. Meaning, the 2003 DCL guidance would be
applicable to issues of long-term debt in existence up to the effective date of the new regulation.
Prospective application would allow colleges and universities time to transition to the new requirements.

Nonprofit institutions have large investments in old and newly constructed buildings on their campuses.
They hold long-term debt that both directly and indirectly relates to brick and mortar, but showing a direct
relationship between issues of debt within all debt obtained for long-term purposes and capitalized asset
acquisition can be challenging. A variety of factors make this difficult, including institutional longevity;
contributions that support PP&E payment and payout timing; variability in build, renovation, and
maintenance schedules; and debt consolidations, restructurings, and refinancing over decades. The 2003
DCL was issued because ED observed these difficulties. Please refer to Appendix I for illustrations.

II. Proposed requirements attempt to establish new accounting principles

To satisfy regulatory requirements and avoid conflicts with GAAP, NACUBO strongly believes that
additional information about leases, long-term lines of credit, related party promises to give, split-
interest gifts, and so forth, can and should be provided in the Supplemental Schedule rather than in
the notes to the financial statements. NACUBO supports the subcommittee recommendation that
institutions would provide a Supplemental Schedule to ED with their annual financial statement
submission through EZ Audit. In other words, we favor the disclosures ED is seeking, but through a
Supplemental Schedule rather than through notes in financial statements.

NACUBO is aware of, and supports, the subcommittee’s recommendation that the Supplemental
Schedule (Section 2 Appendices A and B) contain all financial elements needed to calculate the
composite score ratios and indicate where the information can be found in the audited financial
statements, as well as be reviewed (evaluated) by an institution’s independent auditors in relation to the
financial statements as a whole. The result would be a dedicated paragraph in the audit opinion that would
indicate whether the Supplemental Schedule is fairly stated in relation to the financial statements as a
whole.

The NPRM, specifically pages 37274 – 37279 and Appendices A and B, makes explicit reference to
additional disclosures in the financial statements (thus altering GAAP). NACUBO strongly recommends
that all proposed additional disclosure requirements in the audited financial statements be removed. See
Appendix II for suggested corrections that would not alter GAAP and allow for presentation of additional
information.

III. Appendices A and B: formula, calculations, and readability

NACUBO agrees that a third section (Section 3) is needed in Appendices A and B (proprietary and
nonprofit institutions, respectively) to conform with needed changes in Sections 1 and 2 that reflect FASB
updates and the proposed Financial Responsibility Supplemental Schedule. However, Section 3 of
Appendix B for nonprofit institutions displays ratio numerator and denominator terminology and
formulas for proprietary institutions. It appears that Section 3 of Appendix A was inadvertently copied
and pasted into Section 3 of Appendix B. (See Appendix II to these comments for reference and needed
corrections.)

NACUBO finds both sets of appendices confusing and difficult to read, partly because these sections
switch between landscape and portrait orientations. Consistency in both page layout and content would
make these sections considerably easier to follow. Given the number of tables in the appendices that
require a wide-page layout to accommodate their full content, landscape orientation likely would be the
most appropriate format for all sections. Additionally, tables in the appendices can be hard to decipher,
since labels and corresponding numbers or totals do not always align. For example, in Section 3 of Appendix B (page 37320), the “Example Financial Statements and Composite Score” table runs onto the next page without sufficient notation clarifying that it extends, making the chart difficult to follow. Further, the intended total for line 30: “Total Net Assets with Donor Restrictions” appears to be zero. However, the actual total—26,990,000—is on the line below because the bolded number is too large for the space provided, making it inappropriately wrap around into a second line (row). This sizing issue cascades through the rest of the table on that page, resulting in a confusing and unaligned chart.

NACUBO recommends that the formula for expendable net assets begin with “total net assets.” The Supplemental Schedule example uses “total net assets.” The NPRM includes terminology changes that were not suggested by the subcommittee or presented and publicly discussed with the full borrower defense negotiating committee. Specifically, the definition of expendable net assets in Section 1 of Appendix B begins with “net assets with donor restrictions,” adds “net assets without donor restrictions,” and then subtracts “net assets with donor restrictions: restricted in perpetuity.” The subcommittee’s recommendations began with “total net assets” and then subtracted “net assets with donor restrictions: restricted in perpetuity.” Because, per FASB, nonprofit institutions can delineate the nature of their donor restrictions, beginning with “total net assets” alleviates possible misinterpretation about sub-groupings of “net assets with donor restrictions.” Financial statement users’ confusion about donor restrictions was one of the reasons behind FASB’s new guidance in ASU 2016-14.

IV. Lease transition period

NACUBO would like to draw attention to the departure of the NPRM from the subcommittee’s recommended transition for leases. ED proposes a six-year transition for all operating leases, while the subcommittee recommended applying the six-year transition only to operating leases in effect in the initial financial reporting period/year following the effective date of the new regulation.

It is NACUBO’s understanding that the subcommittee’s recommendation was based on the notion that the forbearance time should correspond to the period during which institutions made business decisions under FASB’s current guidance on leases rather than FASB’s 2016 lease guidance (ASU 2016-02). Since 2010, all higher education institutions that follow FASB should have known FASB was preparing to make the change.

V. Termination of the Perkins Loan Program

As a result of the Perkins Loan Program’s termination, institutions may elect to liquidate their portfolio and turn all loans over to ED for servicing. A liquidation decision can result in a one-time loss that nonprofit institutions will likely display separately or as a non-operating loss on their financial statements (Statement of Activities). The current regulation would exclude extraordinary losses and losses from discontinued operations from the composite score calculation. However, FASB no longer recognizes extraordinary items in financial reporting, and Perkins liquidation would not qualify as a discontinued operation under FASB.

Consequently, we ask that ED clarify the treatment of Perkins program liquidation losses. NACUBO recommends that non-operating losses related to Perkins liquidation be deemed infrequent and unusual in nature and thus excluded from composite score calculations. Institutions should not be penalized for the dissolution of the Perkins Loan Program.
Conclusion
NACUBO fully supports the undertaking by ED to penalize institutions that are deceitful and have lied or misled students, leaving them without a degree but with the burden of debt. Further, we recognize the responsibility of the federal government to protect taxpayers from the real costs of discharge relief.

NACUBO finds certain sections of the NPRM troubling and others to be substantial improvements. We hope you will consider our concerns and urge you to revise the rules before final publication as you work to achieve your laudable goal of protecting students from truly fraudulent schools. Please direct your questions to Liz Clark, senior director of federal affairs (202.861.2553, lclark@nacubo.org) or Sue Menditto, director of accounting policy (202.861.2542, smenditto@nacubo.org).

Sincerely yours,

Susan Whealler Johnston  
NACUBO President and CEO

On behalf of:

Association of Governing Boards of Universities and Colleges  
Coalition of Higher Education Assistance Organizations  
National Association of Independent Colleges and Universities

Cc: Ms. Barbara Hoblitzell  
Ms. Annmarie Weisman  
Mr. Brian Smith  
Mr. John Kolotos  
Mr. Ian Foss
Appendix I

Illustrations of Long-Term Debt at Nonprofit Institutions of Higher Education

- A College incurs external debt to construct a building. The College also, at some point, obtains a line of credit and other debt for operating purposes. The College ultimately refinances the long-term debt, lines of credit, and operating debt outstanding into one new debt issue. Initially, the controller’s office allocates the new bond issue between operating activities and PP&E when computing the composite score but has to make assumptions about which portion was being paid off with the principal payments each year. After a few years, this becomes more and more difficult and professional judgment governs the allocations. The proposed new definition of debt obtained for long-term purposes would not accommodate these allocations.

- Another institution has an internal borrowing in 2008 that equates to 15 percent of their endowment for the construction of a building. The institution regularly pays back the endowment pool for this internal borrowing at a rate of 5.5 percent. The internal borrowing is acceptable under GAAP and is used as a fixed rate asset allocation diversification strategy (for the endowment investment pool). (The internal borrowing also is encouraged by most trustees who are extremely conservative and debt-averse. The strategy worked to the institution’s advantage in 2008 after the market collapsed.) In 2016, when interest rates are at record lows and the market continues an upward trajectory, the institution determines it would be better to secure a long-term loan and reimburse the endowment investment pool for market-based investing and diversification. The proposed definition of debt obtained for long-term purposes would not accommodate this scenario because the proceeds are not directly used for the acquisition of capitalized assets.

- A nonprofit religiously affiliated institution accepts a donated building that it renovates while using sections not under renovation for educational activities over the first five years it is in service. Approximately 30 percent of the renovations are maintenance-related and therefore not capitalized. The college secures long-term financing in the fourth year for maintenance and capitalized updates. The entire amount of the financing can only be related to capitalized updates, but the building has value as a donated asset. The upgrades qualitatively improve the institution’s ability to serve students and increase the fair value of the building beyond its appraised amount when donated. Under the current rule, the college can use the entire amount of the debt obtained for long-term purposes because it does not exceed the total net value of PPE in the aggregate or singularly for the building in this scenario. The proposed definition of debt obtained for long-term purposes would not allow the entire amount of long-term debt related to this building to be used in the calculation of expendable net assets.

A myriad of challenges similar to the above illustrations became obvious during the first five years of the current financial responsibility regulation, which is why a “Dear College Letter” updating the definition of debt obtained for long-term purposes was issued in 2003 (as follows).

Revised Policy Guidance (GEN-01-02)

Many concerns have been raised since this guidance was issued. Particularly, institutions were concerned over the difficulty in associating a particular debt amount with the acquisition of PP&E when reporting the amount of “debt obtained for long-term purposes.”
The Department has considered these concerns and has decided to rescind its earlier guidance and issue new guidance in this area. Under this revised guidance for the Primary Reserve Ratio calculation, *all* long-term debt obtained for the institution’s purposes may be included. However, it is important to note that the overall level of “debt obtained for long-term purposes” that can be included in the numerator of the Primary Reserve Ratio is limited under the regulations so that it cannot exceed the amount of the institution’s net property, plant, and equipment.
APPENDIX II

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Extracted Pages: Suggested Edits
reporting requirements in proposed paragraph (f), we adopt the timeframe currently in § 668.28 for notifying the Department of 90/10 failures. For all other events addressed in these proposed regulations, we believe 10 days provides sufficient time for institutions to report those events and for the Department to take action, if needed.

**Financial Ratios (§ 668.172)**

*Statute:* Section 498(c)(1) of the HEA authorizes the Secretary to establish ratios and other criteria for determining whether an institution has the financial responsibility required to (1) provide the services described in its official publications; (2) provide the administrative resources necessary to comply with title IV, HEA requirements; and (3) meet all of its financial obligations, including but not limited to refunds of institutional charges and repayments to the Secretary for refunds of institutional charges and (3) meet all of its financial obligations.

**Proposed Changes:** The Secretary proposes to calculate a composite score in accordance with new standards issued by the Financial Accounting Standards Board (FASB) in Accounting Standards Update (ASU) 2016–02, ASC 842 (Leases). However, the Department will need to update the composite score calculation to take into account this dramatic change in FASB standards, which it cannot do immediately. As a result, for 6 years following the implementation of the new FASB standards, or following the publication of new composite score formula regulations to take into account the FASB change, whichever is shorter, institutions that fail the composite score based on the new FASB standards, but would have had a passing composite score under the former FASB standards (with regard to leases), may request the calculation of an alternative composite score based on additional data provided by the institution to the Department to enable it to calculate an alternative composite score excluding operating leases. The Department will use the higher of those two composite scores to determine whether the institution is financially responsible.

*Reasons:* The new FASB reporting requirements could negatively impact an institution’s composite score even though the underlying financial condition of the institution has not changed. Based on changes FASB announced in February, 2016 in ASU–2016–02, operating leases longer than 12 months will be recorded under GAAP as separate liabilities and right-of-use assets. Consequently, adding operating leases to the Balance Sheet (for proprietary institutions) or to the Statement of Financial Position (for non-profit institutions) could decrease the Equity Ratio if the right-of-use assets in the Modified Assets category significantly increased compared to Modified Equity or Modified Net Assets, resulting in a lower composite score. With that in mind, some of the non-Federal negotiators argued that, due to the long-term nature of some leases, the Department should allow an institution some time to change its business model regarding leases before applying the new FASB standards to its existing leases for purposes of calculating the composite score. We agreed, and in the final session of negotiated rulemaking proposed a six year transition period during which existing leases would be treated under the previous FASB guidance.

However, upon further review, we believe that a transition period would only partially defer and not adequately address the consequences of the accounting changes and how those changes are reflected in the composite score. While we recognize that schools must adhere to the new FASB reporting requirements, which will be reflected in their audited statements, we believe that including assets and liabilities associated with those transactions in the composite score, where no lease-related assets or liabilities are currently included, could encourage some institutions to make changes in their business model that have negative consequences for students. To mitigate a negative impact of the new lease reporting requirements on their composite score, institutions may enter into shorter term but higher cost leases instead of continuing in or entering into longer term leases which typically have better terms, such as lower monthly lease rates and more cost-effective lease improvements. Shorter, more expensive leases may raise costs for institutions, and therefore students, and could result in more frequent campus relocations or closures that may interfere with students’ ability to complete their programs and raise the risk to taxpayers of increased numbers of closed school student loan discharges. We believe that it is undesirable to put an institution in a position where it could incur increased costs from short-term leases or where the institution would have to relocate or close because it could not negotiate or renew a favorable lease agreement without jeopardizing its composite score. In some instances, even if the school is able to relocate to another comparable facility, the State authorizing body or the accreditor may not approve that relocation if the new facility is more than a certain geographic distance or travel time away from the original campus, if it is on a different public transportation line or if it lacks comparable access via public transportation. In such a case, the campus move is treated as a campus closure, which requires the institution to either teach-out the closing campus or suffer the financial losses associated with closed school loan discharges. The higher costs of short-term leases or relocation costs, or both, would likely be passed on to students. Unfortunately, the composite score currently has no mechanism for automatic updates in the event of changes in accounting standards.

For these reasons, and because the impact of the upcoming FASB lease requirements is unknown, we believe it is necessary to update the composite score regulations to take into account this and other FASB changes. Future negotiated rulemaking will be required to update the composite score regulations, so until such time as revised composite score regulations are established, or for six years after implementation of the new FASB standards (for leases), the Department will allow institutions the option to continue calculating the composite score under current GAAP standards. Therefore, the Department proposes an approach under which we will calculate a composite score for all institutions under the new FASB requirements when they take effect since all audited financial statements will be based on the new requirements, but we will allow institutions to provide additional data to support the calculation of an alternative composite score under current GAAP standards (GAAP prior ASU–2016–2 implementation), and in such a case, to use the higher of the two composite scores to evaluate financial responsibility, for the next six years or until revised composite score regulations are promulgated, which ever period is shortest.

**Appendix A to Subpart L, Part 668**

*Statute:* Section 498(c)(1) of the HEA authorizes the Secretary to establish ratios and other criteria for determining whether an institution has the financial responsibility required to (1) provide...
the services described in its official publications, (2) provide the administrative resources necessary to comply with title IV, HEA requirements, and (3) meet all of its financial obligations, including but not limited to refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred for programs administered by the Secretary.

Current Regulations: As provided under §668.172(a), appendix A to subpart L contains three sections that illustrate how the composite score is calculated for a proprietary institution. Section 1 sets forth the ratios and defines the ratio terms. Section 2 provides a model Balance Sheet and Statement of Income and Retained Earnings with numbered line entries and shows the numbered entries that are used to calculate each of the financial ratios. Section 3 takes the calculated ratios from Section 2 and applies strength factors and weights associated with each ratio to derive a blended, or composite, score that the Secretary uses to determine, in part, whether the institution is financially responsible.

Proposed Changes: The Secretary proposes revising these three sections by amending the first section to reflect changes in accounting standards and to make other clarifying changes that the Secretary believes will improve compliance with the financial responsibility standards. We propose to add a new section 2 that would provide a Supplemental Schedule which schools would be required to provide as part of their annual financial statement audit submission. Proposed section 2 would be titled, “Section 2: Financial Responsibility Supplemental Schedule Requirement and Example.” Proposed Section 3 would combine sections 2 and 3 from the current regulations, and would be titled, “Example Financial Statements and Composite Score Calculation.”

Appendix A, Section 1
For a proprietary institution, the Secretary proposes to revise the numerator, Adjusted Equity, and the denominator, Total Expenses, of the Primary Reserve Ratio.

Changes to Adjusted Equity: As currently defined, Adjusted Equity includes “post-employment and retirement liabilities” and “all debt obtained for long-term purposes.” The Secretary proposes changing these terms to “post-employment and defined benefit pension liabilities” and “all debt obtained for long-term purposes, not to exceed property, plant and equipment (PP&E).” In addition, the Secretary proposes to clarify the term “unsecured related party receivables” by referencing the related entity disclosure requirements under §668.23(d). With regard to determining the value of PP&E, which is currently the amount net of accumulated depreciation, the Secretary proposes to include construction in progress and lease right-of-use assets.

As noted above, we propose to amend the current definition of “debt obtained for long-term purposes”, which currently includes the short-term portion of the debt, up to the amount of PP&E. Specifically, we are proposing to change the meaning of the term “debt obtained for long-term purposes”, to include lease liabilities for lease right-of-use assets and the short-term portion of the debt, up to the amount of net PP&E. However, if an institution wishes to include the debt as part of the total debt obtained for long-term purposes, including debt obtained through long-term lines of credit, the institution would have to provide a disclosure in the financial statements that the debt, including lines of credit, exceeds twelve months and was used to fund capitalized assets (i.e., PP&E or capitalized expenditures per Generally Accepted Accounting Principles (GAAP)). The disclosure for the debt would include the issue date, term, nature of capitalized amounts and amounts capitalized. The debt obtained for long-term purposes would be limited to those amounts disclosed in the financial statements that were used to fund capitalized assets. Any other debt amount, including long-term lines of credit used to fund operations, would be excluded from debt obtained for long-term purposes.

Changes to Total Expenses:
Currently, the regulations provide that the term “Total Expenses” excludes income tax, discontinued operations, extraordinary losses or change in accounting principle. The Department proposes to change that term to “Total Expenses and Losses” and define the proposed term as: All expenses and losses, (excludes income tax, discontinued operations not classified as an operating expense or change in accounting principle), less any losses on investments, post-employment and defined benefit pension plans and annuities. Any losses on investments would be the net loss for the investments and Total Expenses and Losses would include the non-service component of net periodic pension and other post-employment plan expenses.

Net Income Ratio
The Department proposes to modify the numerator of the Net Income ratio, “Income before Taxes,” and the denominator, “Total Revenues.” Currently, “Income before Taxes” is taken directly from the institution’s audited financial statements. The Department proposes to define “Income before Taxes” to include all revenues, gains, expenses and losses incurred by the institution during the accounting period. Income before taxes would not include income taxes, discontinued operations not classified as an operating expense or changes in accounting principle.

With regard to the denominator, we propose to change the term “Total Revenues” to “Total Revenues and Gains.”

We note that while the current regulations define the term “Total Pretax Revenues” (total operating revenues + non-operating revenues and gains, where investments gains should be recorded net of investment losses), that term was erroneously published and we should have used the term Total Revenues. The Secretary proposes to correct that error and define the term, “Total Revenues and Gains” as all revenues and gains not including positive income tax amounts, discontinued operations not classified as an operating gain, or change in accounting principle (investment gains would be recorded net of investment losses).

Reasons: The proposed changes are intended to reflect current accounting standards, particularly Accounting Standards Update (ASU) 2016–2 Leases (Topic 842), and clarify how the composite score is calculated.

When implemented, ASU 2016–2 will require all non-profit and proprietary institutions to recognize the assets and liabilities that arise from leases. In accordance with FASB Concepts Statement No. 6, Elements of Financial Statements, all leases create an asset and a liability as of the date of the Statement of Financial Position, or Balance Sheet, and therefore, an institution must recognize those lease assets and lease liabilities as of that date. This is a change compared to the previous GAAP approach, which did not require lease assets and lease liabilities to be recognized for most leases.

Under this ASU, a proprietary institution is required to recognize in its Balance Sheet a liability for the value of the lease agreement (the lease liability) and a right-of-use asset representing its right to use the underlying asset for lease terms longer than one fiscal year. The principal difference from previous accounting guidance is that the lease assets and lease liabilities arising from
all of the financial elements required to calculate the composite score and a corresponding or related reference to the Statement of Financial Position, Statement of Activities, Schedule of Natural to Functional Expenses, Balance Sheet, Income Statement, or Notes to the Financial Statements. The amount entered in the Supplemental Schedule for each element would be directly to a line item, be part of a line item, the directly to a note, or be part of a note in the financial statements. In addition, the audit opinion letter would contain additional analysis of the Supplemental Schedule.

Reasons: As a result of the FASB updates, some elements needed to calculate the composite score would no longer be readily available in the audited financial statements, particularly for non-profit institutions. The Subcommittee suggested using a Supplemental Schedule as a means to address this issue. Moreover, by referencing the financial statements, the Supplemental Schedule would increase transparency in how the composite score is calculated for both institutions and the Department. The Subcommittee requested and received advice from auditors and accountants that the burden stemming from the Supplemental Schedule would be minimal. The Subcommittee believed, and we agree, that any burden is outweighed by the need for the information and the increase in transparency.

Appendices A and B, Section 3

Proposed changes: Proposed Section 3 would combine, conceptually, Sections 2 and 3 of the current appendices. While we do not propose to modify the current strength factors and weights for each, proposed Section 3 would be updated to reflect changes in terminology based on the changes in accounting standards and modifications to the item amounts used in the example financial statements.

Reasons: We propose to revise current Section 3 of appendices A and B to conform with the proposed changes to Sections 1 and 2 of those appendices.

Appendix B to Subpart L, Section 1

Statute: Section 498(c)(1) of the HEA authorizes the Secretary to establish ratios and other criteria for determining whether an institution has the financial responsibility required to (1) provide the services described in its official publications, (2) provide the administrative resources necessary to comply with title IV, HEA requirements, and (3) meet all of its financial obligations, including but not limited to refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred in programs administered by the Secretary.

Current Regulations: Appendix B to subpart L contains three sections that illustrate how the composite score is calculated for a non-profit institution. Specifically, Section 1 sets forth the ratios and defines the terms. Section 2 provides a model Statement of Activities and Balance Sheet with numbered line entries and shows the numbered entries that are used to calculate each of the financial ratios. Section 3 takes the calculated ratios from Section 2 and applies strength factors and weights associated with each ratio to derive a blended, or composite, score that the Secretary uses to determine, in part, whether the institution is financially responsible.

Proposed Changes: We propose to revise appendix B by amending the definitions of terms used in Section 1 to reflect changes in accounting standards and other changes that the Secretary believes would clarify how the composite score is calculated. We previously noted in the discussion for appendix A the proposed changes to Sections 2 and 3 of appendix B.

Appendix B, Section 1

The Department proposes to modify the definition of the terms “Expendable Net Assets” and “Total Expenses” as those terms are used in calculating the Primary Reserve Ratio. Under the current regulations, the “Expendable Net Assets” are:

(unrestricted net assets) + (temporarily restricted net assets) – (annuities, term endowments and life income funds that are temporarily restricted) – (intangible assets) – (net property, plant and equipment) * + (post-employment and retirement liabilities) + (all debt obtained for long-term purposes) ** – (unsecured related-party receivables).

* The value of property, plant and equipment is net of accumulated depreciation/amortization, including capitalized lease assets.

** The value of 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. If the institution wishes to include the debt, including debt obtained through long-term lines of credit in total debt obtained for long-term purposes, the institution must include a disclosure in the financial statements or in the Supplemental Schedule that the debt, including lines of credit exceeds twelve months and was used to fund capitalized assets (i.e., property, plant and equipment or capitalized expenditures per Generally Accepted Accounting Principles (GAAP)). The disclosures that must be presented for any debt to be included in expendable net assets include the issue date, term, nature of capitalized amounts and amounts capitalized. Institutions that do not include debt in total debt obtained for long-term purposes, including long-term lines of credit, do not need to provide any additional disclosures other than those required by GAAP. The debt obtained for long-term purposes will be limited to only those amounts disclosed in the financial statements that were used to fund capitalized assets.

Any debt amount including related to long-term lines of credit used to fund operations must be excluded from debt obtained for long-term purposes.

**** Unsecured related party receivables as required at 34 CFR 668.23(d).

Under the current regulations, the term “Total Expenses” is defined as “Total unrestricted expenses taken directly from the audited financial statements.” We propose to change the term to “Total Expenses without Donor Restrictions and Losses without Donor Restrictions.” In addition, the Department proposes to define the new term “Total Expenses without Donor Restrictions and Losses without Donor Restrictions” as all expenses and losses without donor restrictions from the Statement of Activities less any losses

defined benefits pension plan liabilities) + (all-long-term debt obtained for long-term purposes, not to exceed total net property, plant and equipment) **** – (unsecured related-party transactions) *****.

* Net assets with donor restrictions: Restricted in perpetuity is subtracted from total net assets. The amount of net assets with donor restrictions: Restricted in perpetuity is disclosed as a line item, part of line item, in a note, or part of a note in the financial statements or in the Supplemental Schedule.

** Annuities, term endowments and life income funds with donor restrictions are subtracted from total net assets. The amount of annuities, term endowments and life income funds with donor restrictions is disclosed in as a line item, part of line item, in a note, or part of a note in the financial statements or in the Supplemental Schedule.

*** The value of property, plant and equipment includes construction in progress and lease right-of-use assets and is net of accumulated depreciation/amortization.

**** All Debt obtained for long-term purposes, not to exceed total net property, plant and equipment includes lease liabilities for lease right-of-use assets and the short-term portion of the debt, up to the amount of net property, plant and equipment. If an institution wishes to include the debt, including debt obtained through long-term lines of credit in total debt obtained for long-term purposes, the institution must include a disclosure in the financial statements or in the Supplemental Schedule that the debt, including lines of credit exceeds twelve months and was used to fund capitalized assets (i.e., property, plant and equipment or capitalized expenditures per Generally Accepted Accounting Principles (GAAP)). The disclosures that must be presented for any debt to be included in expendable net assets include the issue date, term, nature of capitalized amounts and amounts capitalized. Institutions that do not include debt in total debt obtained for long-term purposes, including long-term lines of credit, do not need to provide any additional disclosures other than those required by GAAP. The debt obtained for long-term purposes will be limited to only those amounts disclosed in the financial statements that were used to fund capitalized assets.

Any debt amount including related to long-term lines of credit used to fund operations must be excluded from debt obtained for long-term purposes.

***** Unsecured related party receivables as required at 34 CFR 668.23(d).

Under the current regulations, the term “Total Expenses” is defined as “Total unrestricted expenses taken directly from the audited financial statements.” We propose to change the term to “Total Expenses without Donor Restrictions and Losses without Donor Restrictions.” In addition, the Department proposes to define the new term “Total Expenses without Donor Restrictions and Losses without Donor Restrictions” as all expenses and losses without donor restrictions from the Statement of Activities less any losses.

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without donor restrictions on investments, post-employment and defined benefit pension plans, and annuities. (For institutions that have defined benefit pension and other post-employment plans, total expenses include the non-service component of net periodic pension and other post-employment plan expenses and these expenses will be classified as non-operating. Consequently such expenses will be labeled non-operating or included with “other changes — non-operating changes in net assets without donor restrictions” when the Statement of Activities includes an operating measure).

The numerator of the Equity Ratio, Modified Net Assets, is currently defined as “(total assets) – (intangible assets) – (unsecured related-party receivables).” We propose to change the definition of Modified Net Assets to “(net assets without donor restrictions) + (net assets with donor restrictions) – (intangible assets) – (unsecured related party receivables)

For the Net Income Ratio, the current regulations specify that the amounts for both the numerator, “Change in Unrestricted Net Assets,” and the denominator, “Total Unrestricted Revenue”, are taken directly from the audited financial statements. We propose to rename the numerator as “Change in Net Assets without Donor Restrictions,” and the denominator as “Total Revenue without Donor Restriction and Gains without Donor Restrictions.” In addition, the Department proposes that the denominator, Total Revenue, would include amounts released from restriction plus total gains. The Department notes that with regard to gains, investment returns are reported as a net amount (interest, dividends, unrealized and realized gains and losses net of external and direct internal investment expense). Institutions that separately report investment spending as operating revenue (e.g. spending from funds functioning as endowment) and remaining net investment return as a non-operating item, will need to aggregate these two amounts to determine if there is a net investment gain or a net investment loss (net investment gains are included with total gains).

**Reasons:** The proposed changes are intended to reflect current accounting standards and clarify how the composite score is calculated. Many of the proposed changes stem from significant changes to the accounting standards, primarily ASU 2016–2 Leases (Topic 842) and 2016–14 Not-for-Profit Entities (Topic 958), ASU 2016–2 and ASU 2016–14 respectively.

When implemented, ASU 2016–2 will require all non-profit and proprietary institutions to recognize the assets and liabilities that arise from leases. In accordance with FASB Concepts Statement No. 6, Elements of Financial Statements, all leases create an asset and a liability as of the Statement of Financial Position, or Balance Sheet, date and, therefore, an institution must recognize those lease assets and lease liabilities as of that date. A non-profit institution must recognize in the Statement of Financial Position a liability for the value of the lease agreement (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The principal difference from previous guidance is that the lease assets and lease liabilities arising from operating leases should be recognized in the Statement of Financial Position.

Under ASU 2016–14, a non-profit institution must present on the face of the Statement of Financial Position amounts for two classes of net assets at the end of the period, rather than for the currently required three classes. That is, the institution will report amounts for net assets with donor restrictions and net assets without donor restrictions, as well as the currently required amount for total net assets. Temporarily restricted net assets, which were previously reported, will be eliminated as a class of net assets. A non-profit institution must also present on the face of the Statement of Activities the amount of the change in each of the two classes of net assets rather than the currently required three net asset classes, as well as report the currently required amount of the change in total net assets for the period. These changes were made to simplify the complexity arising from using the three classes of net assets which focus on the absence or presence of donor imposed restrictions and whether those restrictions are temporary or permanent.

ASU 2016–14 eliminated the use of the term “temporarily restricted net assets” because of difficulties with classifying assets as temporarily restricted. On its face, under this ASU, assets with donor restrictions would not be considered expendable net assets. In discussions with the Subcommittee, the Department agreed that there are some elements of assets with donor restrictions that could be considered expendable. An example of this would be an endowment where the corpus is permanently restricted by the donor, but the earnings from the endowment can be used to pay salaries. The Subcommittee put forward that the primary element of assets with donor restrictions that is not expendable is “net assets with donor restrictions: restricted in perpetuity.” Subtracting “net assets with donor restrictions: restricted in perpetuity” from total net assets net assets with donor restrictions plus net assets without donor restrictions roughly approximates the amount that would have been included in the composite score using unrestricted net assets and temporarily restricted net assets. Likewise, using the amounts from annuities, term endowments and life income funds with donor restrictions, approximates the amount of annuities, term endowments and life income funds that are temporarily restricted that would have been used prior to the proposed change.

The Subcommittee asked the Department to consider including defined benefit pension plan liabilities as a retirement liability that would be added back to expendable net assets. The Subcommittee stated that changes in accounting practice that now require defined pension plan liabilities to be on the face of the financial statements, as well as the required insurance for pension liabilities and the timing of when the liability would be payable, all indicate that defined benefit plan liabilities should not reduce expendable net assets. In addition, the Subcommittee argued that all other retirement liabilities are already included in post-employment liabilities, and rather than having post-employment and retirement liabilities for expendable net assets, it would be clearer to the community to use post-employment and defined benefit pension plan liabilities. The Department agreed that the Subcommittee proposals would clarify how defined benefit pension plan liabilities will be treated for expendable net assets.

As a result of ASU 2016–2, the Department proposes including the right-of-use asset from leases as part of PP&E (which is a component of Expendable Net Assets in the Primary Reserve ratio). During the general discussions with the Subcommittee about PP&E, the Subcommittee recommended that the Department should include construction in progress in PP&E for purposes of calculating the Primary Reserve ratio. The Subcommittee pointed out that by its very nature, construction in progress could not be considered an expendable asset because it cannot be easily converted to cash or cash equivalents when an institution is in financial difficulty. The Department agreed and
proposes here to include construction in progress with PP&E.

Initially, the discussion in the Subcommittee surrounding how to treat debt obtained for long-term purposes in calculating the composite score, focused around the change in accounting for leases under ASU 2016–2. Under ASU 2016–2 the liability for leases is not considered debt for accounting purposes. The Subcommittee noted that although the lease liability was not debt, the liability was clearly associated with PP&E and argued that it should be included as debt obtained for long-term purposes in the composite score calculation. This discussion then expanded to consider the various types of debt and liabilities that the Department encounters in evaluating financial statements and computing the composite score. As noted above, in 2017, both GAO and OIG issued audit reports that found that the Department was not doing enough to limit manipulation of the composite score to protect students from institutions that could be in danger of financial difficulty. The Department is aware that some institutions use debt, including long-term lines of credit, to improve their composite scores without actually using the debt for long-term purposes. The use of debt to improve the composite score, including long-term lines of credit, can be difficult to identify from examining an institution’s audited financial statements. When the composite score was originally developed, the long-term debt that was intended to be added back for purposes of expendable net assets was the amount of debt that was used for the purchase of capitalized assets. We question the viability of an institution that uses debt, including long-term lines of credit, for current operations as opposed to long-term purposes. Consequently, the amount of long-term debt that is added back for expendable net assets should have some relationship to PP&E—and therefore should not be included in debt obtained for long-term purposes if it is not used for the purchase of capitalized assets.

The Subcommittee specifically discussed the treatment of long-term lines of credit with regard to debt obtained for long-term purposes and agreed with the Department’s proposed treatment of long-term lines of credit. The Department proposes extending this treatment to all debt not used for long-term purposes to further reduce or mitigate manipulation of the composite score.

In the preamble to the 1997 Regulations, the Department was clear that expenses for the Primary Reserve Ratio included losses; however, the Appendices to subpart L did not include language concerning losses. Since the inception of the composite score, the Department has included losses as part of the denominator for the Primary Reserve Ratio. The proposed changes to the denominator for the Primary Reserve Ratio reflect changes in the accounting terminology and clarify what has consistently been the Department’s practice. With regard to losses, the Subcommittee suggested that there were some losses that should not be reflected in the Primary Reserve Ratio. The Subcommittee proposed that the Primary Reserve Ratio should not include any losses without donor restrictions on investments, post-employment and defined benefit pension plans and annuities. The Department agreed.

All of the proposed changes to the Equity Ratio are based solely on changes in accounting terminology as a result of ASU 2016–14. The change to the numerator for the Net Income Ratio is based solely on changes in accounting terminology as a result of ASU 2016–14. The proposed changes to the denominator are based on changes in accounting terminology and Department practice concerning gains. In the preamble to the 1997 Regulations, the Department was clear that revenue for the Net Income Ratio included gains; however the Appendices to subpart L did not include language concerning gains. Since the inception of the composite score, the Department has included gains as part of the denominator for the Net Income Ratio.

The Department proposes to add a reference to the regulatory disclosure requirement for unsecured related party transactions under § 668.23(d). While the Department believes that this reference promotes clarity, Subcommittee members representing the non-profit sector expressed concern that certain aspects of related party transactions unique to the non-profit sector required more thorough explanation. The Department agreed, and provides additional information below.

For both proprietary and non-profit institutions, related party receivables or other related assets are excluded from the composite score if the amount is not secured and perfected as of the date of the financial statements. The Related Party disclosure should provide enough detail about the relationship, transaction(s) and any conditions for the Department to be able to make a determination on whether the related party receivable or other related assets are properly secured for inclusion in the composite score.

For non-profit schools, related party contributions receivables from board members would be allowed to be included in secured related party receivables if there was no additional business relationship or transactions with the board member or his/her family or related entities and there were no additional conditions associated with the contribution if disclosed in the related party disclosure.

Appendices to subpart L did not include gains; however the Department agreed, and provides additional information below.

Current Regulations: As provided in § 668.175, an institution that is not financially responsible under the general standards in § 668.171 may begin or continue to participate in the title IV, HEA programs only by qualifying under an alternative standard.

Under the zone alternative in § 668.175(d), a participating institution that is not financially responsible solely because its composite score is less than 1.5 may participate as a financially responsible institution for no more than three consecutive years, but the Secretary requires the institution to (1) make disbursements to students under the heightened cash monitoring or reimbursement payment methods described in § 668.162, and (2) provide timely information regarding any adverse oversight or financial event, including any withdrawal of owner’s equity from the institution. In addition, the Secretary may require the institution to (1) submit its financial statement and compliance audits earlier than the date specified in § 668.23(a)(4), or (2) provide information about its current operations and future plans.

Under the provisional certification alternative in § 668.175(f), an institution that is not financially responsible...
as an operating gain, or change in accounting principle (investment gains) should be recorded net of investment losses.

*Unsecured related party receivables as required at 34 CFR 668.23(d).

**The value of property, plant and equipment includes construction in progress and lease right-of-use assets, and is net of accumulated depreciation/amortization.

***All debt obtained for long-term purposes, not to exceed total net property, plant and equipment includes lease liabilities for lease right-of-use assets and the short-term portion of the debt, up to the amount of net property, plant and equipment. If an institution wishes to include the debt, including debt obtained through long-term lines of credit in total debt obtained for long-term purposes, the institution must include a disclosure in the financial statements or in the Supplemental Schedule that the debt, including long-term lines of credit in total debt obtained for long-term purposes, the institution must include a disclosure in the financial statements or in the Supplemental Schedule that the debt, including long-term lines of credit in total debt obtained for long-term purposes, the institution must include a disclosure in the financial statements or in the Supplemental Schedule that the debt, including long-term lines of credit in total debt obtained for long-term purposes, the institution must include a disclosure in the financial statements or in the Supplemental Schedule that the debt, including long-term lines of credit

Section 2: Financial Responsibility Supplemental Schedule Requirement and Example

A Supplemental Schedule must be submitted as part of the required audited financial statements submission. The Supplemental Schedule contains all of the financial elements required to compute the composite score. Each item in the Supplemental Schedule must have a reference to the Balance Sheet, Statement of (Loss) Income, or Notes to the Financial Statements. The amount entered in the Supplemental Schedules should tie directly to a line item, be part of a line item, tie directly to a note, or be part of a note in the financial statements. When an amount is zero, the institution would identify the source of the amount as NA (Not Applicable) and enter zero as the amount in the Supplemental Schedule. The audit opinion letter must contain a paragraph that references the auditor’s additional analysis of the financial responsibility Supplemental Schedule.

Executive Orders 12866, 13563, and 13771

Under Executive Order 12866, the Secretary must determine whether this regulatory action is “significant” and, therefore, subject to the requirements of the Executive Order and subject to review by the Office of Management and Budget (OMB). Section 3(f) of Executive Order 12866 defines a “significant regulatory action” as an action likely to result in a rule that may—

(1) Have an annual effect on the economy of $100 million or more, or adversely affect a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities in a material way (also referred to as an “economically significant” rule).

(2) Create serious inconsistency or otherwise interfere with an action taken or planned by another agency;

(3) Materially alter the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or

(4) Raise novel legal or policy issues arising out of legal mandates, the President’s priorities, or the principles stated in the Executive order.

Under Executive Order 12866, section 3(f)(1), this regulatory action is economically significant and subject to review by OMB. Also under Executive Order 12866 and the Presidential Memorandum “Plain Language in Government Writing”, the Secretary invites comment on how easy these regulations are to understand in the Clarity of the Regulations section.

Under Executive Order 13771, for each new regulation that the Department proposes for notice and comment or otherwise promulgates that is a significant regulatory action under Executive Order 12866 and that imposes total costs greater than zero, it must identify two deregulatory actions. For FY 2018, no regulations exceeding the agency’s total incremental cost allowance will be permitted, unless required by law or approved in writing by the Director of OMB. These proposed regulations are a deregulatory action under E.O. 13771 and therefore the two-for-one requirements of E.O. 13771 do not apply.

We have also reviewed these regulations under Executive Order 13563, which supplements and explicitly reaffirms the principles, structures, and definitions governing regulatory review established in Executive Order 12866. To the extent permitted by law, Executive Order 13563 requires that an agency—

(1) Propose or adopt regulations only on a reasoned determination that their benefits justify their costs recognizing that some benefits and costs are difficult to quantify;

(2) Tailor its regulations to impose the least burden on society, consistent with obtaining regulatory objectives and taking into account—among other things, and to the extent practicable—the costs of cumulative regulations;

(3) In choosing among alternative regulatory approaches, select those approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity);

(4) To the extent feasible, specify performance objectives, rather than the behavior or manner of compliance a regulated entity must adopt; and

(5) Identify and assess available alternatives to direct regulation, including economic incentives—such as user fees or marketable permits—to encourage the desired behavior, or provide information that enables the public to make choices.

Executive Order 13563 also requires an agency “to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible.” The Office of Information and Regulatory Affairs of OMB has emphasized that these techniques may include “identifying changing future compliance costs that might result from technological innovation or anticipated behavioral changes.”

Under Executive Order 13563, the Secretary certifies that the best available techniques were used to quantify the impacts of these regulations. Finally, the Secretary certifies that this regulatory action would not unduly interfere with State, local, and tribal governments in

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(i) Provisional certification alternative. (1) The Secretary may permit an institution that is not financially responsible to participate in the title IV, HEA programs under a provisional certification for no more than three consecutive years if—

(i) The institution is not financially responsible because it does not satisfy the general standards under §668.171(b), its recalculated composite score under §668.171(e) is less than 1.0, it is subject to an action or event under §668.171(c) or (d) that has an adverse material effect on the institution as determined by the Secretary, or because of an audit opinion described in §668.171(h); or

(ii) The institution is not financially responsible because of a condition of past performance, as provided under §668.174(a), and the institution demonstrates to the Secretary that it has satisfied or resolved that condition; and

(2) Under this alternative, the institution must—

(i) Submit to the Secretary an irrevocable letter of credit that is acceptable and payable to the Secretary, or provide other financial protection described under paragraph (h) of this section, for an amount determined by the Secretary that is not less than 10 percent of the title IV, HEA program funds received by the institution during its most recently completed fiscal year, except that this requirement does not apply to a public institution;

(ii) Demonstrate that it was current on its debt payments and has met all of its financial obligations, as required under §668.171(b)(3), for its two most recent fiscal years;

(iii) Comply with the provisions under the zone alternative, as provided under paragraphs (d)(2) and (3) of this section.

(3) If at the end of the period for which the Secretary provisionally certified the institution, the institution is still not financially responsible, the Secretary may again permit the institution to participate under a provisional certification but the Secretary—

(i) May require the institution, or one or more persons or entities that exercise substantial control over the institution, as determined under §668.174(b)(1) and (c), or both, to provide to the Secretary financial guarantees for an amount determined by the Secretary to be sufficient to satisfy any potential liabilities that may arise from the institution’s participation in the title IV, HEA programs; and

(ii) May require one or more of the persons or entities that exercise substantial control over the institution, as determined under §668.174(b)(1) and (c), to be jointly or severally liable for any liabilities that may arise from the institution’s participation in the title IV, HEA programs.

(h) Financial protection. In lieu of submitting a letter of credit for the amount required by the Secretary under this section, the Secretary may permit an institution to—

(1) Provide the amount required in the form of other surety or financial protection that the Secretary specifies in a notice published in the Federal Register:

(2) Provide cash for the amount required; or

(3) Enter into an arrangement under which the Secretary offsets the amount of title IV, HEA program funds that an institution has earned in a manner that ensures that, no later than the end of a six to twelve-month period selected by the Secretary, the amount offset equals the amount of financial protection the institution is required to provide. The Secretary uses the funds to satisfy the debts and liabilities owed to the Secretary that are not otherwise paid directly by the institution, and provides to the institution any funds not used for this purpose during the period covered by the agreement, or provides to the institution any remaining funds if the institution subsequently submits other financial protection for the amount originally required.

8. Appendix A to subpart L is revised to read as follows:

Appendix A to Subpart L of Part 668—Ratio Methodology for Propriety Institutions

Section 1: Ratio and Ratio Terms

Primary Reserve Ratio

Adjusted Equity

Total Expenses and Losses

Equity Ratio

Modified Equity

Modified Assets

Net Income Ratio

Income Before Taxes

Total Revenue and Gains

Total Expenses and Losses excludes income tax, discontinued operations not classified as an operating expense or change in accounting principle and any losses on investments, post-employment and defined benefit pension plans and annuities. Any losses on investments would be the net loss for the investments. Total Expenses and Losses includes the nonservice component of net periodic pension and other post-employment plan expenses.

Modified Equity = (total owner’s equity) – (intangible assets) – (unsecured related-party receivables)

Modified Assets = (total assets) – (intangible assets) – (unsecured related-party receivables)

Income Before Taxes includes all revenues, gains, expenses and losses incurred by the school during the accounting period. Income before taxes does not include income taxes, discontinued operations not classified as an operating expense or changes in accounting principle.

Total Revenues and Gains does not include positive income tax amounts, discontinued operations not classified as an operating gain, or change in accounting principle (investment gains should be recorded net of investment losses).

* Unsecured related party receivables as required at 34 CFR 668.23(d)

** The value of property, plant and equipment includes construction in progress and lease right-of-use assets, and is net of accumulated depreciation/amortization.

*** All debt obtained for long-term purposes, not to exceed total net property, plant and equipment includes lease liabilities for lease right-of-use assets and the short-term portion of the debt, up to the amount of net property, plant and equipment. If an institution wishes to include the debt, including debt obtained through long-term lines of credit in total debt obtained for long-term purposes, the institution must include a disclosure in the financial statements or the Supplemental Schedule that the debt, including lines of credit exceeds twelve months and was used to fund capitalized assets (i.e. property, plant and equipment or capitalized expenditures per Generally Accepted Accounting Principles (GAAP)). The disclosures that must be presented for any debt to be used in adjusted equity include the issue date, term, nature of capitalized amounts and amounts capitalized. Institutions that do not include debt in total debt obtained for long-term purposes, including long-term lines of credit, do not need to provide any additional disclosures other than those required by GAAP. The debt obtained for long-term purposes will be limited to only those amounts disclosed in the financial statements that were used to fund capitalized assets. Any debt amount including related to long-term lines of credit used to fund operations must be excluded from debt obtained for long-term purposes.

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### SECTION 2: Financial Responsibility Supplemental Schedule Requirement and Example

A Supplemental Schedule must be submitted as part of the required audited financial statements submission. The Supplemental Schedule contains all of the financial elements required to compute the composite score. Each item in the Supplemental Schedule must have a reference to the Balance Sheet, Statement of (Loss) Income, or Notes to the Financial Statements. The amount entered in the Supplemental Schedules should tie directly to a line item, be part of a line item, tie directly to a note, or be part of a note in the financial statements. When an amount is zero, the institution would identify the source of the amount as NA (Not Applicable) and enter zero as the amount in the Supplemental Schedule. The audit opinion letter must contain a paragraph that references the auditor's additional analysis of the financial responsibility Supplemental Schedule.

**"Financial Responsibility Supplemental Schedule"**

Example location of number in the financial statements and/or notes - the number reference to sample numbers; however, could be more lines based on financial statements and/or notes.

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Total Equity</th>
<th>Adjusted Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>31</td>
<td>Balance Sheet - Total Equity</td>
<td>Total equity</td>
<td>3,035,000</td>
</tr>
<tr>
<td>4, 10</td>
<td>Balance Sheet - Related party receivable, net and Receivable from affiliate, net and Related party note*</td>
<td>Unsecured related party receivables and/or other related party assets</td>
<td>1,130,000</td>
</tr>
<tr>
<td>8</td>
<td>Balance Sheet - Property, Plant and Equipment, net*</td>
<td>Property, plant and equipment, net - including construction in progress</td>
<td>7,000,000</td>
</tr>
<tr>
<td>9</td>
<td>Balance Sheet - Lease right-of-use asset*</td>
<td>Lease right-of-use asset</td>
<td>2,500,000</td>
</tr>
<tr>
<td>11</td>
<td>Balance Sheet - Goodwill*</td>
<td>Intangible assets</td>
<td>80,000</td>
</tr>
<tr>
<td>27</td>
<td>Balance Sheet - Post-employment and pension liability*</td>
<td>Post-employment and defined pension plan liabilities</td>
<td>300,000</td>
</tr>
<tr>
<td>20, 24</td>
<td>Balance Sheet - Notes payable (both current and long-term)*</td>
<td>Long-term debt - for long-term purposes</td>
<td>5,400,000</td>
</tr>
<tr>
<td>17, 25</td>
<td>Balance Sheet - Lease right-of-use assets liability (both current and long-term)*</td>
<td>Lease right-of-use asset liability</td>
<td>2,100,000</td>
</tr>
<tr>
<td>19, 23</td>
<td>Balance Sheet - Line of Credit-for Long-Term Purposes (both current and long-term) and Line of credit note*</td>
<td>Line of credit - for long-term purposes</td>
<td>575,000</td>
</tr>
<tr>
<td>40, 42, 44, 45</td>
<td>Statement of (Loss) Income - Total Operating Expenses, Interest Expense, Loss on Impairment of Assets and Loss on Disposal of Assets*</td>
<td>Total Expenses and Losses:</td>
<td>5,900,000</td>
</tr>
</tbody>
</table>

**Note:** With regard to supplementary information, the auditor's objective is to (1) evaluate the presentation in relation to the financial statements as a whole and (2) to report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole. See AICPA auditing standard AU-C725.
** In the example the number came from the actual financial statements; however, the number could come from the notes of the financial statements or be part of a number in the financial statements or financial statements notes. The note and/or line item would be the reference to the number that includes the amount and/or note addresses the number.

Insert on previous page:

*** If an institution wishes to include long-term lines of credit in total debt obtained for long-term purposes, the institution must include a disclosure in the financial statements or Supplemental Schedule that the lines of credit exceed twelve months and was used to fund capitalized assets (i.e., property, plant, and equipment or capitalized expenditures per Generally Accepted Accounting Principles (GAAP)). If not in the financial statement disclosures include in the Supplemental Schedule the long-term line of credit issue date, term, nature of capitalized amounts and amounts capitalized.
### SECTION 3: Example Financial Statement and Composite Score Calculation

#### BALANCE SHEET

<table>
<thead>
<tr>
<th>Line</th>
<th>Current Assets</th>
<th>Line</th>
<th>Current Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Cash and cash equivalents</td>
<td>14</td>
<td>Accounts payable</td>
</tr>
<tr>
<td>2</td>
<td>Accounts receivable, net</td>
<td>15</td>
<td>Accrued expenses</td>
</tr>
<tr>
<td>3</td>
<td>Prepaid expenses</td>
<td>16</td>
<td>Deferred revenue</td>
</tr>
<tr>
<td>4</td>
<td>Related party receivable</td>
<td>17</td>
<td>Leases right-of-use assets liability</td>
</tr>
<tr>
<td>5</td>
<td>Related party receivable, secured</td>
<td>18</td>
<td>Line of credit – operating</td>
</tr>
<tr>
<td>6</td>
<td>Student loans receivable, net</td>
<td>19</td>
<td>Line of credit - for long term purposes</td>
</tr>
</tbody>
</table>

### Total Current Assets: 3,610,000

| Line | Property, plant and equipment, net | Line | Debt-
|------|----------------------------------|------|-
| 7    |                                   | 20  | Note payable |
| 8    |                                   | 21  | Total Current Liabilities |
| 9    | Lease right-of-use assets, net | 22  | Line of credit – operating |
| 10   | Receivable from affiliate, net | 23  | Line of credit - for long term purposes |
| 11   | Goodwill | 24  | Notes payable |
| 12   | Deposits | 25  | Lease right-of-use asset liabilities |
| 13   | Total Assets | 26  | Other liabilities |

### Total Assets: 14,210,000

#### STATEMENT OF (LOSS) INCOME

<table>
<thead>
<tr>
<th>Line</th>
<th>Revenue</th>
<th>Line</th>
<th>Operating Expenses</th>
<th>Line</th>
<th>Other Income (expense)</th>
<th>Line</th>
<th>Income Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>33</td>
<td>Tuition and fees, net</td>
<td>36</td>
<td>Education expense</td>
<td>42</td>
<td>Interest expense</td>
<td></td>
<td></td>
</tr>
<tr>
<td>34</td>
<td>Clinic revenue</td>
<td>37</td>
<td>General expense</td>
<td>43</td>
<td>Interest income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>35</td>
<td>Total Revenue</td>
<td>38</td>
<td>Occupancy expense</td>
<td>44</td>
<td>Loss on impairment of assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>39</td>
<td>Depreciation and Amortization</td>
<td>45</td>
<td>Loss on disposal of assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Operating Income (Loss): 2,450,000

### Total Operating Expenses: 4,250,000

### Total Other Income (Expense): (1,380,000)

### Net Income Before Income Taxes: 1,070,000

### Income taxes: 267,000

### Net Income (Loss): 803,000

<table>
<thead>
<tr>
<th>Line</th>
<th>Equity</th>
<th>Line</th>
<th>Total Liabilities and Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>29</td>
<td>Common stock</td>
<td>32</td>
<td>Total Liabilities and Equity</td>
</tr>
<tr>
<td>30</td>
<td>Retained earnings</td>
<td>33</td>
<td>Total Equity</td>
</tr>
</tbody>
</table>

### Total Liabilities: 11,175,000

### Total Equity: 3,035,000

### Total Liabilities and Equity: 14,210,000
Calculating the Composite Score

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Lines</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Primary Reserve Ratio</strong></td>
<td>31-11-(4+10)-(8+9)+27+(17+19+20+23+24+25)</td>
</tr>
<tr>
<td><strong>Equity Ratio</strong></td>
<td>31 -(4+10) -11</td>
</tr>
<tr>
<td><strong>Net Income Ratio</strong></td>
<td>48 /Total Revenues and Gains</td>
</tr>
<tr>
<td></td>
<td>700,000 / Modified assets / 1,825,000 / 6,970,000</td>
</tr>
</tbody>
</table>

**Step 1:** Calculate the strength factor score for each ratio by using the following algorithms:

- Primary Reserve strength factor score = 20 x the primary reserve ratio result
- Equity strength factor score = 6 x the equity ratio result
- Net Income strength factor score = 1 + (33.3 x net income ratio result)

If the strength factor score for any ratio is greater than or equal to 3, the strength factor score for that ratio is 3.
If the strength factor score for any ratio is less than or equal to -1, the strength factor score for that ratio is -1.

**Step 2:** Calculate the weighted score for each ratio and calculate the composite score by adding the three weighted scores

- Primary Reserve weighted score = 30% x the primary reserve strength factor score
- Equity weighted score = 40% x the equity strength factor score
- Net Income weighted score = 30% x the net income strength factor score

Composite Score = the sum of all weighted scores
Round the composite score to one digit after the decimal point to determine the final score

<table>
<thead>
<tr>
<th>RATIO</th>
<th>Ratio</th>
<th>Strength Factor</th>
<th>Weight</th>
<th>Composite Scores</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary Reserve Ratio</td>
<td>0.1186</td>
<td>2.3729</td>
<td>30%</td>
<td>0.7119</td>
</tr>
<tr>
<td>Equity Ratio</td>
<td>0.1404</td>
<td>0.8423</td>
<td>40%</td>
<td>0.3369</td>
</tr>
<tr>
<td>Net Income Ratio</td>
<td>0.1535</td>
<td>3.0000</td>
<td>30%</td>
<td>0.9000</td>
</tr>
</tbody>
</table>

**TOTAL Composite Score - Rounded** 1.9
9. Appendix B to subpart L is revised to read as follows:

Appendix B Subpart L of Part 668—Ratio Methodology for Private Non-Profit Institutions

Section 1: Ratio and Ratio Terms

Primary Reserve Ratio  Expendable Net Assets
Total Expenses without Donor Restrictions and Losses without Donor Restrictions
Equity Ratio  Modified Net Assets
Modified Assets
Net Income Ratio  Change in Net Assets without Donor Restrictions
Total Revenue without Donor Restrictions and Gains without Donor Restrictions
Definitions

Expendable Net Assets = (net assets without donor restrictions) + (net assets with donor restrictions) - (net assets with donor restrictions: restricted in perpetuity) *(annuities, term endowments and life income funds with donor restrictions) **(intangible assets) - (net property, plant and equipment) *** + (post-employment and defined benefit pension plan liabilities) + (all long-term debt obtained for long-term purposes, not to exceed total net property, plant and equipment) **** = (unsecured related party transactions) *****

Total Expenses without Donor Restrictions and Losses without Donor Restrictions = All expenses and losses without donor restrictions from the Statement of Activities less any losses without donor restrictions on investments, post-employment and defined benefit pension plans and annuities. (For institutions that have defined benefit pension and other post-employment plans, total expenses include the non-service component of net periodic pension and other post-employment plan expenses, and these expenses will be classified as non-operating. Consequently such expenses will be labeled non-operating or included with "other changes—non-operating changes—in net assets without donor restrictions" when the Statement of Activities includes an operating measure).

Modified Net Assets = (net assets without donor restrictions) + (net assets with donor restrictions) - (intangible assets) - (unsecured related party receivables)

Modified Assets = (total assets) - (intangible assets) - (unsecured related party receivables)

Change in net assets without donor restrictions is taken directly from the audited financial statements.

Total Revenue without Donor Restriction and Gains without Donor Restrictions = total revenue (including amounts released from restriction) plus total gains. With regard to gains, investment returns are reported as a net amount (interest, dividends, unrealized and realized gains and losses net of external and direct internal investment expense). Institutions that separately report investment spending as operating revenue (e.g., spending from funds functioning as endowment) and remaining net investment return as a non-operating item, will need to aggregate these two amounts to determine if there is a net investment gain or a net investment loss (net investment gains are included with total gains).

* Net assets with donor restrictions: Restricted in perpetuity is disclosed as a line item, part of line item, in a note, or part of a note in the financial statements or in the Supplemental Schedule.

** Annuities, term endowments and life income funds with donor restrictions is subtracted from total net assets. The amount of net assets with donor restrictions: Restricted in perpetuity is disclosed as a line item, part of line item, in a note, or part of a note in the financial statements or in the Supplemental Schedule.

*** The value of property, plant and equipment includes construction in progress and lease right-of-use assets, and is net of accumulated depreciation/amortization.

**** All Debt obtained for long-term purposes, not to exceed total net property, plant and equipment includes lease liabilities for lease right-of-use assets and the short-term portion of the debt, up to the amount of net property, plant and equipment. All Debt obtained for long-term purposes, not to exceed total net property, plant and equipment includes lease liabilities for lease right-of-use assets and the short-term portion of the debt, up to the amount of net property, plant and equipment. If an institution wishes to include the debt, including debt obtained through long-term lines of credit in total debt obtained for long-term purposes, the institution must include a disclosure in the financial statements or in the Supplemental Schedule that the debt, including lines of credit exceeds twelve months and was used to fund capitalized assets (i.e., property, plant and equipment) or capitalized expenditures per Generally Accepted Accounting Principles (GAAP). The disclosures that must be presented for any debt to be included in expendable net assets include the interest rate, term, nature of capitalized amounts and amounts capitalized. Institutions that do not include debt in total debt obtained for long-term purposes, including long-term lines of credit, do not need to provide any additional disclosures other than those required by GAAP. The debt obtained for long-term purposes will be limited to only those accounts disclosed in the financial statements that were used to fund capitalized assets. Any debt amount including related to long-term lines of credit used to fund operations must be excluded from debt obtained for long-term purposes.

***** Unsecured related party receivables as required at 34 CFR 668.23(d). For non-profit schools, related party contributions would be allowed to be included in secured related party receivables if there was no significant business relationship or transactions with the board member or his/her family or related entities and there were no additional conditions associated with the contribution if disclosed in the related party disclosure or Supplemental Schedule.
SECTION 2: Financial Responsibility Supplemental Schedule Requirement and Example

A Supplemental Schedule must be submitted as part of the required audited financial statements submission. The Supplemental Schedule contains all of the financial elements required to compute the composite score. Each item in the Supplemental Schedule must have a reference to the Statement of Financial Position, Statement of Activities, Schedule of Natural to Functional Expenses, or Notes to the Financial Statements. The amount entered in the Supplemental Schedule should tie directly to a line item, be part of a line item, tie directly to a note, or be part of a note in the financial statements. When an amount is zero, the institution would identify the source of the amount as NA (Not Applicable) and enter zero as the amount in the Supplemental Schedule. The audit opinion letter must contain a paragraph that references the auditor’s additional analysis of the financial responsibility Supplemental Schedule.

<table>
<thead>
<tr>
<th>Example location of number in the financial statements and/or notes - the number reference to sample numbers; however, could be more lines based on financial statements and/or notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary Reserve Ratio:</td>
</tr>
<tr>
<td>-----------------------</td>
</tr>
<tr>
<td>Statement of Financial Position - Total Net Assets</td>
</tr>
<tr>
<td>Statement of Financial Position - Related party receivable and Related party note disclosure</td>
</tr>
<tr>
<td>Statement of Financial Position - Contribution receivable, net and Related party note disclosure**</td>
</tr>
<tr>
<td>Statement of Financial Position - Property, plant and equipment, net</td>
</tr>
<tr>
<td>Statement of Financial Position - Lease right-of-use assets, net</td>
</tr>
<tr>
<td>Statement of Financial Position - Goodwill</td>
</tr>
<tr>
<td>Statement of Financial Position - Post-employment and pension liabilities</td>
</tr>
<tr>
<td>Statement of Financial Position - Note Payable*</td>
</tr>
<tr>
<td>Statement of Financial Position - Lease right-of-use of asset liability</td>
</tr>
<tr>
<td>Statement of Financial Position - Line of credit - for long-term purposes***</td>
</tr>
<tr>
<td>Statement of Financial Position - Annuities**</td>
</tr>
<tr>
<td>Statement of Financial Position - Term Endowments**</td>
</tr>
<tr>
<td>Statement of Financial Position - Life Income Funds**</td>
</tr>
<tr>
<td>Statement of Financial Position - Perpetual Funds**</td>
</tr>
</tbody>
</table>

Net assets with donor restrictions: restricted in perpetuity

The audit opinion letter on the financial statements must also include an opinion (or disclaimer of opinion) as to whether the Supplemental Schedule is fairly stated in all material respects in relation to the financial statements as a whole.

When calculating Expendable Net Assets the subcommittee recommended using "Total Net Assets" as a starting point. This reduces the possibility of errors. The proposed regs used (net assets without donor restrictions + net assets with donor restrictions). If ED does not use total net assets then this supplemental schedule needs to refer to the two net asset classes.
<table>
<thead>
<tr>
<th>Statement</th>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statement of Activities - (Investment return appropriated for spending), Total Operating Expenses, Investments, net of annual spending gain (loss), Other components of net periodic pension costs, Pension-related changes other than net periodic pension, Change in value of split-interest agreements and Other gains (loss)*</td>
<td>Total expenses without donor restrictions</td>
<td>52,980,000</td>
</tr>
<tr>
<td>(35), 43, 45, 46, 47, 48, 49</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Activities - (Investment return appropriated for spending) and Investments, net of annual spending, gain (loss)*</td>
<td>Net investment losses</td>
<td>400,000</td>
</tr>
<tr>
<td>(35), 45</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Activities - Change in value of split-interest agreements</td>
<td>Change in value of split-interest agreements</td>
<td>80,000</td>
</tr>
<tr>
<td>48</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Activities - Pension-related changes other than periodic pension*</td>
<td>Pension-related changes other than net periodic costs</td>
<td>350,000</td>
</tr>
<tr>
<td>47</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Financial Position - Net Assets without Donor Restrictions</td>
<td>Net assets without donor restrictions</td>
<td>15,190,000</td>
</tr>
<tr>
<td>24</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Financial Position - Total Net Assets with Donor Restriction</td>
<td>Net assets with donor restrictions</td>
<td>11,800,000</td>
</tr>
<tr>
<td>30</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Financial Position - Goodwill</td>
<td>Intangible assets</td>
<td>500,000</td>
</tr>
<tr>
<td>10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Financial Position - Related party receivable and Related party note disclosure</td>
<td>Unsecured related party receivables</td>
<td>100,000</td>
</tr>
<tr>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Financial Position - Contribution receivable, net and Related party note disclosure**</td>
<td>Related party contribution receivable, net - only with significant relationship</td>
<td>0</td>
</tr>
<tr>
<td>NA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Financial Position - Total assets</td>
<td>Total assets</td>
<td>76,240,000</td>
</tr>
<tr>
<td>12</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Financial Position – Goodwill</td>
<td>Intangible assets</td>
<td>500,000</td>
</tr>
<tr>
<td>10</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Financial Position - Related party receivables and Related party note disclosure</td>
<td>Unsecured related party receivables</td>
<td>100,000</td>
</tr>
<tr>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Financial Position - Contribution receivable, net and Related party note disclosure**</td>
<td>Related party contribution receivable, net - only with significant relationship</td>
<td>0</td>
</tr>
<tr>
<td>NA</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Activities - Change in Net Assets Without Donor Restrictions</td>
<td>Change in Net Assets Without Donor Restrictions</td>
<td>(80,000)</td>
</tr>
<tr>
<td>51</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Activities - (Net assets released from restriction), Total Operating Revenue and Other Additions and Sale of Fixed Assets, gains (losses)</td>
<td>Total Revenues and Gains</td>
<td>52,900,000</td>
</tr>
<tr>
<td>38, (35), 50</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* In the example the number came from the actual financial statements; however, the number could come from the notes of the financial statements.

** In the example the number came from the actual financial statements; however, the number could come from the notes of the financial statements or be part of a number in the financial statements or financial statements notes. The note and/or line item would be the reference to the number that includes the amount and/or note addresses the number.
**SECTION 3: Example Financial Statements and Composite Score Calculation**

<table>
<thead>
<tr>
<th>STATEMENT OF FINANCIAL POSITION</th>
<th>STATEMENT OF ACTIVITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lin e</td>
<td></td>
</tr>
<tr>
<td>1 Cash and cash equivalents</td>
<td>Changes in Net Assets Without Donor Restrictions</td>
</tr>
<tr>
<td>2 Accounts receivable, net</td>
<td>Operating Revenue and Other Additions:</td>
</tr>
<tr>
<td>3 Prepaid expenses</td>
<td>33 Tuition and fees, net</td>
</tr>
<tr>
<td>4 Related party receivable</td>
<td>34 Contributions</td>
</tr>
<tr>
<td>5 Contributions receivable, net</td>
<td>35 Investment return appropriated for spending</td>
</tr>
<tr>
<td>6 Student loans receivable, net</td>
<td>36 Auxiliary enterprises</td>
</tr>
<tr>
<td>7 Investments</td>
<td>37 Net assets released from restriction</td>
</tr>
<tr>
<td>8 Property, plant and equipment, net</td>
<td>Total Operating Revenue and Other Additions</td>
</tr>
<tr>
<td>9 Lease right-of-use asset, net</td>
<td>52,100,000</td>
</tr>
<tr>
<td>10 Goodwill</td>
<td>Operating Expenses and Other Deductions:</td>
</tr>
<tr>
<td>11 Deposits</td>
<td>39 Education and research expenses</td>
</tr>
<tr>
<td>12 Total Assets</td>
<td>40 Depreciation and Amortization</td>
</tr>
<tr>
<td></td>
<td>41 Interest expense</td>
</tr>
<tr>
<td></td>
<td>42 Auxiliary enterprises</td>
</tr>
<tr>
<td></td>
<td>43 Total Operating Expenses</td>
</tr>
<tr>
<td></td>
<td>Total Liabilities</td>
</tr>
<tr>
<td></td>
<td>44 Change in Net Assets from Operations</td>
</tr>
<tr>
<td></td>
<td>Non-Operating Changes</td>
</tr>
<tr>
<td></td>
<td>45 Investments, net of annual spending, gain (loss)</td>
</tr>
<tr>
<td></td>
<td>46 Other components of net periodic pension costs</td>
</tr>
<tr>
<td></td>
<td>47 Pension-related changes other than net periodic pension costs</td>
</tr>
<tr>
<td></td>
<td>48 Change in value of split-interest agreements</td>
</tr>
<tr>
<td></td>
<td>49 Other gains (losses)</td>
</tr>
</tbody>
</table>

Insert on previous page:
*** If an institution wishes to include long-term lines of credit in total debt obtained for long-term purposes, the institution must include a disclosure in the financial statements or Supplemental Schedule that the lines of credit exceeds twelve months and was used to fund capitalized assets (i.e., property, plant and equipment or capitalized expenditures per Generally Accepted Accounting Principles (GAAP)). If not in the financial statement disclosures include in the Supplemental Schedule the long-term line of credit issue date, term, nature of capitalized amounts and amounts capitalized.
Calculating the Composite Score

<table>
<thead>
<tr>
<th>Lines</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-29</td>
</tr>
<tr>
<td>43+46+49</td>
</tr>
</tbody>
</table>

Step 1: Calculate the strength factor score for each ratio by using the following algorithms:
- **Primary Reserve strength factor score** = 10 x the primary reserve ratio result
- **Equity strength factor score** = 6 x the equity ratio result
- **Negative net income ratio result** = Net Income strength factor = 1 + (25 x net income ratio result)
- **Positive net income ratio result** = Net Income strength factor = 1 + (50 x net income ratio result)
- **Zero result for net income ratio** = Net income strength factor = 1

If the strength factor score for any ratio is greater than or equal to 3, the strength factor score for the ratio is 3.
If the strength factor score for any ratio is less than or equal to -1, the strength factor score for the ratio is -1.

**Step 2:** Calculate the weighted score for each ratio and calculate the composite score by adding the three weighted scores

- **Primary Reserve weighted score** = \(40\% \times \text{the primary reserve strength factor score}\)
- **Equity weighted score** = \(40\% \times \text{the equity strength factor score}\)
- **Net Income weighted score** = \(20\% \times \text{the net income strength factor score}\)

**Composite Score** = the sum of all weighted scores

Round the composite score to one digit after the decimal point to determine the final score

<table>
<thead>
<tr>
<th>RATIO</th>
<th>Ratio</th>
<th>Strength Factor</th>
<th>Weight</th>
<th>Composite Scores</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary Reserve Ratio</td>
<td>0.1896</td>
<td>0.4855</td>
<td>40%</td>
<td>0.7424</td>
</tr>
<tr>
<td>Equity Ratio</td>
<td>0.3489</td>
<td>2.0933</td>
<td>40%</td>
<td>0.8373</td>
</tr>
<tr>
<td>Net Income Ratio</td>
<td>(0.0015)</td>
<td>0.9623</td>
<td>20%</td>
<td>0.1925</td>
</tr>
</tbody>
</table>

**TOTAL Composite Score - Rounded**

1.8
in part, pursuant to §§ 685.206, 685.214, and 685.216.

* * * * *

[FR Doc. 2018–15823 Filed 7–25–18; 4:15 pm]

BILLING CODE 4000–01–P