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Borrower Defense Negotiated Rulemaking Financial Responsibility Subcommittee

Issue #1: FASB ASU 2016-14, "Presentation of Financial Statements of Not-for-Profit Entities" (Topic 958)

The Change from Three Classes of Net Assets to Two Classes of Net Assets

1. **Are there implications from the change from three classes of net assets to two classes that should be discussed with regard to calculating the composite score?** This change impacts the composite score calculation because new terminology in ASU 2016-14 will make it impossible to calculate the ratios comprising the composite score. Hours of discussion resulted in subcommittee consensus on the following recommendations.
   - **A. <u>The subcommittee recommends:</u>**
     - i. Replacing old terms with new terms
     - ii. In some cases, definitions will need to change (i.e., total expenses, expendable net assets)
   - **B. <u>The subcommittee recommends:</u>**
     - i. A "Financial Responsibility Supplemental Schedule" should be included with the audited financial statements that are submitted with EZ Audit. The "supplemental schedule" would be subject to audit review and result in an auditor's attestation of comfort within the audit opinion.
     - ii. The "Financial Responsibility Supplemental Schedule" would include all attributes needed to calculate each ratio comprising the composite score.
     - iii. The "Financial Responsibility Supplemental Schedule" would also include certain other ratio components that are not required to be displayed or disclosed in the financial statements per Generally Accepted Accounting Principles, as follows:
       1. The perpetual portion of an institution's endowment and other perpetual net assets
       2. Annuities, term endowments, and life income funds: with donor restrictions (but not perpetual restrictions)
       3. Long-term lines of credit, lease liabilities, and all long-term debt (including the related current portion of all debt for long term purposes)
       4. Information concerning the relationship between trustees and the college or university. Trustee contributions receivable (pledges / promises to give) would not be excluded when calculating expendable net assets if the trustee is not an owner, compensated manager, investor, or vendor with a significant business interest in the institutions.
     - **iv.** There would be a new "**Appendix B**" as part of the renegotiated regulation that modifies the existing Appendix B for new terms and definitions and **contains the "Financial Responsibility Supplemental Schedule." (pages 13 – 17)**
   - **C. <u>Illustration (page 2):</u>**
     - **i.** Provides an **illustrative crosswalk** between old and new terms and ratio definitions as a result of ASU 2016-14 and the changes in net asset classes.
     - **ii.** **Note:** pension liabilities replace retirement liabilities: FR Notice, page 41195 of FR083017—"within the context of ASU 2016-14, the subcommittee will consider clarification of treatment of endowment losses, terms of endowments, retirement liabilities, long-term debt, and construction in progress"

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Borrower Defense Negotiated Rulemaking Financial Responsibility Subcommittee

Crosswalk: Current to New Terminology as a result of FASB ASU 2016-14 and Subcommittee Consensus

Ratio	Current Definition	Proposed Definition
Primary Reserve Ratio	**Highlighted terms going away**	**Red Font are new terms**
Numerator: Expendable net assets	(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)	(total net assets) - (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 pension liabilities) + (all debt obtained for long term purposes) - (unsecured related party receivables)
Denominator: Total expenses	the total unrestricted expenses taken directly from the audited financial statements	total expenses without donor restrictions taken directly from the analysis of natural and functional expenses.
Equity Ratio		
Numerator: Modified net assets	(unrestricted net assets) + (temporarily restricted net assets) + (permanently restricted net assets) – (intangible assets) – (unsecured related party receivables)	(net assets without donor restrictions) + (net assets with donor restrictions) – (intangible assets) – (unsecured related party receivables)
Net Income Ratio		
Numerator: Change in unrestricted net assets	Change in Unrestricted Net Assets is taken directly from the audited financial statements	Change in net assets without donor restrictions is taken directly from the audited financial statements
Denominator: Total unrestricted revenue	Total Unrestricted Revenue is taken directly from the audited financial statements (and includes net assets released from restriction during the fiscal year)	Total Revenue, Gains, and Losses: Net Assets without Donor Restrictions is calculated by taking the Change in net assets without donor restrictions and adding total expenses.

Significant Additional Disclosures Concerning Liquidity

2. **How could the Department use the additional liquidity disclosures in evaluating a not-for-profit schools' financial health?**
   A. ASU 2016-14 requires qualitative and quantitative disclosures about liquidity and the availability of financial resources. Information about how an institution manages liquidity is more of a qualitative disclosure. The availability of financial resources will be more of a quantitative disclosure. Although liquidity policies will be interesting, the resource availability disclosures may be of greatest value.
   B. The resource availability disclosures will not use a prescriptive format and it may take 2 -3 years of experience with the disclosure for institutions to coalesce around a consistent approach (and presentation) that clearly communicates all available resources over a twelve-month period from the date of the financial statements.
   C. Subcommittee recommendation:
      i. Because it will likely take preparers and users 2 – 3 years to get experience with interpreting and refining the resource availability disclosure, ED should study the disclosure for institutions showing signs of financial duress (composite scores in the zone, failing scores, or sudden composite score drops).
      ii. ED should partner with subcommittee experts or designate an advisory group to assist with studying the disclosure.
         1. The objective is to determine if the disclosure effectively augments the composite score
         2. Another objective is to recommend financial (stabilization) intervention
            i. Assess impact on the disclosure during the 2 – 3 year "study" period
            ii. Assess correlation between disclosure changes and composite score movement

3. **Are there comparable liquidity disclosures for proprietary schools and, if not, should such disclosures be required of proprietary schools?**
   A. **Subcommittee recommendation:** No further disclosures should be required of proprietary schools with respect to these matters, as <u>there are currently no comparable FASB requirements for proprietary schools</u>
   B. <u>Proprietary schools don't have donor restrictions</u>. Restrictions were the driver of the new NFP disclosure requirement, which is designed to help financial statement users understand how donor restrictions affect resource availability and liquidity.

4. **Do the additional disclosures address when a school borrows from donor restricted funds without proper authorization? If not, should there be a required additional disclosure in the regulations?**
   A. The additional disclosures do not address donor restricted and endowment borrowing
      i. Institutions can borrow from endowment funds as an investment allocation
      ii. Nothing in FASB's literature precludes endowment borrowing
   B. Subcommittee consensus:
      i. This should not be a requirement for all institutions. (Many financially healthy and household name institutions borrow from their endowment as an investment allocation strategy)
      ii. The liquidity and availability disclosures should highlight a lack of available resources for use in a twelve-month period (a proxy for a school's operating cycle).
      iii. Perhaps institutions that lack sufficient resource availability should have to provide information about endowment and other restricted fund borrowing

Investment Return Net of External and Direct Internal Investment Expenses:

5. **Does investment return net of external and direct internal investment expenses impact the composite score, or the manner in which the Department evaluates a school's financial responsibility?**
   A. Prior to ASU 2016-14 institutions had the option to report investment expenses net of investment return or as an expense in the Statement of Activities (SOA).
   B. NACUBO and FASB have observed that reporting investment expenses net of investment return is the prevailing practice.
   C. The ASU clarifies and limits what is considered an investment expense
   D. The vast majority of institutions have externally managed endowments and net few or zero internal investment related expenses against investment return
   E. This may increase total expenses but is not expected to materially alter the primary reserve ratio –even for institutions with very large internally management endowments (such schools tend to have healthy composite scores)
   F. **Subcommittee consensus:** the new netting requirement will not impact the composite score

Placed-In-Service Approach

6. **ASU 2016-14 requires the placed-in-service approach. This approach would not have an impact on net assets, but in the year the asset is placed in service could have a significant positive impact on net assets without donor restriction. How or should the Department consider this impact in evaluating a non-profit school's financial responsibility?**

   A. Requiring the placed-in-service approach would not have an impact on net assets, but in the year the asset is placed in service could have a significant positive impact on net assets without donor restriction.
   B. Subcommittee discussion:
      i. Restricted contributions are released as revenue (without restriction)
      ii. Amounts released from restriction are included when calculating the net income ratio
      iii. Per NACUBO, the new requirement in ASU 2016-14 is already the predominant practice
         a. less than five percent of institutions may not do this
         b. the largest and greatest resourced institutions are more likely to be those that don't follow the prevailing practice, such institutions have healthy composite scores
      iv. ASU 2016-14 would require any amounts previously recognized in net assets without donor restrictions—before the asset is placed-in-service—to be reclassified to net assets with donor restrictions. **The Regulation already allows for one-time adjustments for a change in accounting principle**
   C. **Subcommittee consensus**: the placed-in-service requirement will not impact the composite score

Issue #2: Financial Accounting Standards Board (FASB) Accounting Standards Update, ASU 2016-2, Leases (Topic 842), and the Department's Financial Responsibility Standards.

1. **How should the right-of-use asset be classified for purposes of the composite score?**
   - A. FASB <u>would not</u> consider the right-of-use asset an intangible asset because it represents the right to use a tangible asset; the tangible asset is the asset available for the institution's use.
   - B. **Subcommittee consensus**: the leased asset (right-to-use) would be categorized with property, plant, and equipment when calculating the composite score.

2. **How should the lease liability be treated with respect to the right-of-use asset for the composite score?**
   - A. A lease liability is equal to the present value of the lease payments and is directly related to the right-of-use (property, plant and equipment) asset.
   - B. **Subcommittee consensus**: the lease liability is a long-term liability and will be categorized with long-term debt when calculating the composite score.
     - i. The long-term liabilities (initial maturity exceeds twelve months) related to leased assets would include both the long and short-term portion of the lease liability
     - ii. The sum of long-term lease liabilities and long-term debt cannot exceed the total value of net property, plant and equipment. (Net means property, plant and equipment—including leased assets—less accumulated depreciation and amortization)

3. **How should violations of debt covenants be treated by the Department in evaluating financial responsibility as a result of the changes from ASU 2016-2?**
   - A. A debt covenant violation caused by ASU 2016-2 does not necessarily indicate financial concern because the change in accounting principle did not change the way an institution was operating.
   - B. Institutions should be proactively renegotiating covenants.
   - C. **Subcommittee recommendation –** ED may want to additionally analyze institutions that are not able to renegotiate covenants. (Existing financial responsibility regulations require an institution to report any violation of a loan agreement to ED)

4. **How should any impact to a school's financial statements be treated as a result of the transition requirements?**
   - A. FASB ASU 2016-2 may significantly affect an institution's equity ratio (40% weight). This weight could lead to a significantly lower composite score for institutions that predominantly have operating leases today (no asset or liability on the balance sheet).
   - B. <u>Subcommittee discussion:</u>
     - i. Institutions that currently have a significant volume of operating leases should stress-test their composite scores (i.e. calculate the composite score with and without ASU 2016-2 requirements), and begin to consider changes in business planning and strategy.
     - ii. Although it is common belief that ASU 2016-2 predominantly impacts proprietary institutions, it is likely to also affect non-profit institutions that (a) have sold plant

assets for capital (using operating leases instead), (b) are in urban areas where it is more convenient to have operating leases rather than purchasing or constructing capital assets, (c) are changing program or plant models and have rent expense.

iii. It may take several years for the full impact of ASU 2016-2 to be seen in an institution's financial statements—depending on the timing of lease agreements. Impacted operating leases would typically have terms of three to eight years.

C. **Subcommittee recommendation:**

i. ED should allow a transition period for all institutions (during this time, ED will not use the Regulation's "change in accounting principle" adjustment).

ii. The subcommittee recommends a four-year transition period from the time the renegotiated regulation is in effect.

iii. On the "Financial Responsibility Supplemental Schedule" (included with an institution's audited financial statements (recommended under Issue 1), institutions taking advantage of the four-year transition period will:

1. Report the impact of ASU 2016-02 on operating leases in existence at the time the institution implements the new leasing standard (ASU 2016-02), (existing operating leases are impacted by an accounting change rather than a business decision).
2. Report the incremental additions on their balance sheet—this means additional amounts that were added to assets (right of use or net property, plant and equipment) and additional related liabilities.
3. New leases entered into after the renegotiated regulation is in effect do not qualify for transition period treatment.
    a. If existing operating leases are renegotiated during the transition period, the lease will be considered a new lease and not included with transition period leases (no amounts will be separately reported for these leases).
    b. New leases entered into during the transition period will not be included with transition period leases (no amounts will be reported separately for these leases).
4. The negotiated regulation would contain a new appendix. Appendix A, (paegs 9-12) and Appendix B (pages 13-17), illustrate the new requirements and supplemental schedule. Supplemental Schedules are on pages 11 and 16.

iv. The Department of Education will calculate the ratio with and without the effect of ASU 2016-2; and will use the optimum (higher) composite score for the institution.

v. **Page 8 of this document contains an "illustration of proposed regulatory language" that would be added to 34 CFR 668.172.**

5. **Are there any specific disclosure requirements that should be specified in the regulations due to the discretion allowed in the new disclosures?**

A. Disclosures are designed to provide users with additional information about an entity's ability to meet its lease obligations

B. **Subcommittee recommendation –** There is no need for new requirements because of new disclosures

Illustration
Proposed new paragraph (d) to be added to 34 CFR 668.172

§ 668.172 Financial Ratios.

* * *

(d) *Transition period for treatment of certain operating leases.*

(1) For the purposes of calculating an institution's ratios under this section, a transition period shall apply to operating leases initially entered into before July 1, 2019 that also are subject to *Financial Accounting Standards Board Accounting Codification ASC 842 (Leases)* as right-of-use assets and corresponding lease liabilities.

(2) The transition period is the first four complete fiscal years beginning on or after January 1, 2019 for which the Secretary determines an institution's composite score under this section.

(3) During the transition period, in addition to the ratio calculations otherwise conducted under this section, the Secretary shall calculate transition ratios that exclude the effects of operating leases described in subparagraph (1).

(4) An institution's composite score for any fiscal year during the transition period shall be the greater of— (i) the Secretary's composite score determination based on the transition ratios calculated under subparagraph (3), or (ii) the Secretary's composite score determination under this section without regard to the transition ratios.

<u>SECTION 1: Ratio and Ratio Terms</u>

Primary Reserve Ratio	$\frac{\text{Adjusted Equity}}{\text{Total Expenses}}$
Equity Ratio	$\frac{\text{Modified Equity}}{\text{Modified Assets}}$
Net Income Ratio	$\frac{\text{Income Before Taxes}}{\text{Total Revenues}}$

<u>Definitions:</u>

<u>Adjusted Equity</u> = (total owner's equity) - (intangible assets) - (unsecured related-party receivables) - (net property, plant and equipment)* + (post-employment and **~~retirement~~** **pension** liabilities) + (all debt obtained for long-term purposes)**

<u>Total Expenses</u> excludes income tax, discontinued operations, **~~extraordinary losses,~~** or change in accounting principle**, and includes all components of post-employment and pension expenses**.

<u>Modified Equity</u> = (total owner's equity) - (intangible assets) - (unsecured related-party receivables)

<u>Modified Assets</u> = (total assets) - (intangible assets) - (unsecured related-party receivables)

<u>Income Before Taxes</u> is taken directly from the audited financial statement

<u>Total Pre-Tax Revenues</u> = (total operating revenues) + (non-operating revenue and gains). Investment gains should be recorded net of investment losses. No revenues shown after income taxes (e.g., discontinued operations, ~~extraordinary gains~~, or change in accounting principle) on the income statement should be included.

* The value of plant, property and equipment is net of accumulated depreciation, including capitalized lease **(right to use)** assets.
** The value of all debt obtained for long-term purposes includes lease obligations and the short-term portion of the qualifying debt and lease liabilities, up to the amount of net property, plant and equipment (which includes leases).

Balance Sheet

Line		
1	Cash	$ 190,000
2	Accounts Receivable	1,010,000
3	Prepaid Expenses	150,000
4	Inventories	130,000
5	Note Receivable from Affiliate	200,000
6	Investments	330,000
7	**Total Current Assets**	2,010,000
8	Property and Equipment, net	500,000
9	Amount Due from Owner	170,000
10	Goodwill	80,000
11	Organization Costs	70,000
12	Deposits	60,000
13	**Total Assets**	2,890,000
14	Accounts Payable	200,000
15	Accrued Expenses	330,000
16	Current Portion of Long-Term Debt	120,000
17	Deferred Revenue	650,000
18	**Total Current Liabilities**	1,300,000
19	Long-Term Debt, net of Current Portion	330,000
20	**Total Liabilities**	1,630,000
21	Contributed Capital	440,000
22	Retained Earnings	820,000
23	**Total Owner's Equity**	1,260,000
24	**Total Liabilities and Owner's Equity**	2,890,000

Statement of Income and Retained Earnings

Line		
25	Operating Income	$ 9,700,000
26	Non-Operating Income	300,000
27	**Total Income**	10,000,000
28	Cost of Goods Sold	6,800,000
29	Administrative Expenses	2,600,000
30	Depreciation Expense	60,000
31	Interest Expense	40,000
32 A	**Total Operating Expenses**	9,500,000
32 B	**Post-employment & pension non-service expense**	0
37	Other: Net unusual loss	0
33	Other: Gain on Sale of Investments	10,000
34	**Net Income Before Taxes**	510,000
35	Federal Income Taxes	153,000
~~36~~	~~**Net Income After Taxes**~~	~~(357,000~~
~~37~~	~~Extraordinary Loss, net of Tax~~ Change in Accounting Principle	800,000
38	**Net Income**	(443,000)
39	Retained Earnings, Beginning of year	1,263,000
22	**Retained Earnings, end of year**	820,000

Primary Reserve Ratio = (lines) $\dfrac{23-5-9-10-8+(16+19)^{*}}{32A + 32B} = \dfrac{\$\ 760{,}000}{\$9{,}500{,}000} = 0.080$

Equity Ratio = (lines) $\dfrac{23-5-9-10}{13-5-9-10} = \dfrac{\$\ 810{,}000}{\$2{,}440{,}000} = 0.332$

Net Income Ratio = (lines) $\dfrac{34}{27+33} = \dfrac{\$\ 510{,}000}{\$10{,}010{,}000} = 0.051$

*Long-Term Debt (lines 16+19) cannot exceed Property and Equipment (line 8) in this formula

"Financial Responsibility Supplemental Schedule"

Primary Reserve Ratio:				
	Adjusted Equity:			
23	Total owner's equity		1,260,000	
10	Intangible assets		80,000	
5 + 9	Unsecured related party receivables		370,000	
8	Net property, plant and equipment (PP&E)	*	500,000	
	Post-employment and pension liabilities		0	
	Lease obligations	*	80,000	Note 5
	Long-term lines of credit		50,000	Note 6
	Long-term debt		320,000	Note 7
16 and 19	Total debt obtained for long-term purposes		450,000	
	Total Expenses:			
32 A	Total operating expenses		9,500,000	
32 B	Post-employment & pension non-service expense		0	
	Total expenses		9,500,000	
Equity Ratio:				
	Modified Equity			
23	Total owner's equity		1,260,000	
10	Intangible assets		80,000	
5 + 9	Unsecured related party receivables		370,000	
	Modified Assets:			
13	Total assets		2,890,000	
10	Intangible assets		80,000	
5 + 9	Unsecured related party receivables		370,000	
Net Income Ratio:				
	Income Before Taxes:			
34	Income before taxes		510,000	
	Total Revenues:			
25	Total operating revenue		9,700,000	
26 + 33	Non-operating revenues and gains		310,000	
*	Existing operating leases included in net PP&E as a result of ASU 2016-02		100,000	
*	Related liability: existing operating leases included in PP&E as a result of ASU 2016-02		80,000	

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

Primary Reserve strength factor score = 20 x* Primary Reserve ratio result:	20 x 0.080	= 1.600
Equity strength factor score = 6 x Equity ratio result:	6 x 0.332	= 1.992
Net Income strength factor score = 1 + (33.3 x Net Income ratio result):	1 + (33.3 x 0.051)	= 2.698

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 Primary Reserve strength factor score:	0.30 x 1.600	= 0.480
Equity weighted score = 40% x Equity strength factor score:	0.40 x 1.992	= 0.797
Net Income weighted score = 30% x Net Income strength factor score:	0.30 x 2.698	= 0.809
Composite score = sum of all weighted scores:	0.480 + 0.797 + 0.809	= 2.086
Round the composite score to one digit after the decimal point to determine the final score:		2.1

* The symbol "x" denotes multiplication.

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Appendix B: Ratio Methodology for Private Non-Profit Institutions

Appendix B is updated to reflect (1) FASB ASU 2016-14, "Not-for-Profit Entities: Presentation of Financial Statements of Not-for-Profit Entities," which changes net asset reporting categories, terminology, and the availability of certain information needed to calculate financial responsibility ratios and (2) FASB ASU 2016-02, "Leases," to ensure that newly capitalized assets are included in calculations.

SECTION 1: Ratio and Ratio Terms

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

Definitions:

Expendable Net Assets = (**total net assets**) - (**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 **pension** liabilities) + (all long-term debt, **not to exceed total net property, plant and equipment**)** - (unsecured related party receivables)***

Total Expenses = total expenses **without donor restrictions** taken **directly from the total expenses reported in the analysis of natural and functional expenses.**

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, Gains, and Losses: Net Assets without Donor Restrictions = (**Change in net assets without donor restrictions**) + (total expenses)

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

** GEN – 03-08 (Dear Colleague Letter issued July 2003) - all long-term debt obtained for the institution's purposes may be included and cannot exceed the amount of the institution's net property, plant, and equipment. In addition, the value of all debt obtained for long-term purposes **includes lease obligations** and the short-term portion of the qualifying debt **and lease liabilities**, up to the amount of net property, plant and equipment (**with leases**).

*** **Unsecured related party receivables are "promises to give" from those with a significant business relationship with the reporting entity (that is, owners, investors, compensated managers, or vendors with a significant business relationship with the institution). An auditor attestation concerning trustee pledges not subject to the "unsecured related party receivable subtraction" (i.e. the trustees are not owners, investors, compensated managers, or vendors with a significant business relationship) must be included on the required "Financial Responsibility Supplemental Schedule" to the financial statements.**

SECTION 2: New Terms and Definitions: (from Section 1)

Total net assets
Total net assets will be **readily discernable on the financial statements**—specifically on the Statement of Financial Position.

Net assets with donor restrictions: restricted in perpetuity
This amount can be found on the new "**Financial Responsibility Supplemental Schedule**" included with audited financial statements.

Annuities, term endowments, and life income funds with donor restrictions
This amount can be found on the new "**Financial Responsibility Supplemental Schedule**" included with audited financial statements—**and would not include perpetual annuities and life income funds (which would be included with net assets with donor restrictions: restricted in perpetuity— referenced above).**

Total Expenses
This is defined as total expenses reported in the analysis of natural and functional expenses. The analysis of total expenses by both their function and nature will be in a single location either on the face of the statement of activities, as a schedule in the notes to financial statements, or in a separate financial statement.

Net assets without donor restrictions
Total net assets without donor restrictions will be **readily discernable on the financial statements** – specifically on the Statement of Financial Position.

Net assets with donor restrictions
Total net assets with donor restrictions will be **readily discernable on the financial statements** – specifically on the Statement of Financial Position.

Change in net assets without donor restrictions
The total change in net assets without donor restrictions will be **readily discernable on the financial statements** – specifically on the Statement of Activities.

SECTION 3 PART 1: Information Needed to Calculate the Ratios (Statement of Financial Position, Statement of Activities, Expense Analysis, Financial Responsibility Supplemental Schedule)

STATEMENT OF FINANCIAL POSITION

Line	BALANCE SHEET	Total
1	Cash and cash equivalents	1,000,000
2	Accounts receivable	6,000,000
3	Prepaid expenses	1,500,000
4	Inventories	500,000
5	Contributions receivable	2,000,000
6	Student loans receivable	8,000,000
7	Investments	6,000,000
8	Property and equipment, net	50,000,000
9	Bond insurance proceeds	720,000
10	Goodwill	500,000
11	Deposits	20,000
12	**Total Assets**	**76,240,000**
13	Line of credit	500,000
14	Accounts payable	2,000,000
15	Accrued expenses	3,500,000
16	Deferred revenue	650,000
17	Post-employment and pension liability	6,600,000
18	Long term Debt	36,000,000
19	**Total Liabilities**	**49,250,000**
20	**Net Assets without Donor Restrictions**	**15,190,000**
21	Annuities	300,000
22	John Doe scholarship fund	2,500,000
23	Other donor funds	9,000,000
24	**Net Assets with Donor Restrictions**	**11,800,000**
25	**Total Net Assets**	**26,990,000**
26	**Total Liabilities and Net Assets**	**76,240,000**

STATEMENT OF ACTIVITIES

	Column a	b	c	
Line		Without Donor Restrictions	With Donor Restrictions	Total
27	Tuition and fees	45,000,000		45,000,000
28	Contributions	1,200,000	420,000	1,620,000
29	Auxiliary enterprises	5,500,000		5,500,000
30 / 37	Net assets released from restriction	200,000	(200,000)	0
31	**Total Operating Revenue**	**51,900,000**		**51,900,000**
32	Operating expenses	38,000,000		38,000,000
33	Depreciation	5,000,000		5,000,000
34	Interest expense	2,880,000		2,880,000
35	Auxiliary enterprises	5,200,000		5,200,000
	Total Operating Expenses	**51,080,000**		**51,080,000**
	Change in Net Assets from Operations	**820,000**		**820,000**
	Non-operating revenue	0		**0**
36	**Post-employment & pension non-service expense**	900,000		900,000
	Non-operating Change in Net Assets	**(900,000)**		**(900,000)**
39	**Total Change in Net Assets**	**(80,000)**	**220,000**	**140,000**
40	**Net assets at beginning of year**	**15,270,000**	**11,580,000**	**26,850,000**
41	**Net assets at end of year**	**15,190,000**	**11,800,000**	**26,990,000**

EXPENSE ANALYSIS (from notes or separate statement)

		Education	Student Services	Research	Auxiliaries	Support	Total
	Salaries	13,900,000	2,500,000	4,000,000	3,000,000	2,000,000	25,400,000
	Benefits	3,100,000	700,000	1,200,000	800,000	600,000	6,400,000
	Supplies	1,000,000	1,500,000	2,000,000	1,000,000	800,000	6,300,000
	Services	1,200,000	900,000	2,100,000	1,300,000	500,000	6,000,000
	Depreciation	1,600,000	900,000	1,000,000	1,000,000	500,000	5,000,000
	Interest	960,000	520,000	575,000	575,000	250,000	2,880,000
38	**Total Expenses**	**21,760,000**	**7,020,000**	**10,875,000**	**7,675,000**	**4,650,000**	**51,980,000**

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Appendix B: Ratio Methodology for Private Non-Profit Institutions

"Financial Responsibility Supplemental Schedule"

Primary Reserve Ratio:				
	Expendable Net Assets:			
25	Total net assets		26,990,000	
23 A	**Net assets with donor restrictions: restricted in perpetuity**		8,800,000	Note 4
21	Annuities **with donor restrictions**		300,000	
23 B	Term endowments **with donor restrictions**		200,000	
	Life income funds **with donor restrictions**		0	
10	Intangible assets		500,000	
8	Net property, plant and equipment (PP&E)	*	50,000,000	
17	Post-employment and **pension** liabilities		6,600,000	
	Lease obligations	**	5,000,000	Note 5
	Long-term lines of credit		2,000,000	Note 6
	Long-term debt		29,000,000	Note 7
18	Total debt obtained for long-term purposes		36,000,000	
	Unsecured related party receivables	***	0	
	Total Expenses:			
38	**Total expenses without donor restrictions**		51,980,000	Note 8
Equity Ratio:				
	Modified Net Assets:			
20	**Net assets without donor restrictions**		15,190,000	
24	**Net assets with donor restrictions**		11,800,000	
10	Intangible assets		500,000	
	Unsecured related party receivables	***	0	
	Modified Assets:			
12	Total assets		76,240,000	
10	Intangible assets		500,000	
	Unsecured related party receivables	***	0	
Net Income Ratio:				
	Change in Net Assets Without Donor Restrictions:			
39	Change in net assets without donor restrictions		(80,000)	
	Total Revenue, Gains and Losses: Net Assets Without Donor Restrictions:			
39	Change in net assets without donor restrictions		(80,000)	
38	Total expenses without donor restrictions		51,980,000	

*	Existing operating leases included in net PP&E as a result of ASU 2016-02	2,000,000
**	Related liability: existing operating leases included in PP&E as a result of ASU 2016-02	1,800,000
***	Unsecured related party receivables exclude contributions receivable (promises-to-give / pledges) of $2,000,000 from trustees who are not compensated managers, owners, investors, or vendors with a significant business relationship with the institution.	

SECTION 3 PART 2: Calculating the Ratios (Statement of Financial Position, Statement of Activities, Expense Analysis, Financial Responsibility Supplemental Schedule)

Primary Reserve Ratio = (Lines)	25-23A-23B-21-10-8+18+17	18,790,000	0.361
Expendable net assets / Total expenses	38	51,980,000	

Equity Ratio = (lines)	20+24-10	26,490,000	0.350
Modified net assets / Modified assets	12 - 10	75,740,000	

Net Income Ratio = (lines)	39 b	(80,000)	(.0015)
Change in NA Without Donor Restrictions / Total Revenue, Gains, Losses: NA W/O Donor Restriction	39 b + 38	51,900,000	

SECTION 4: Calculating the Composite Score

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

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% x the primary reserve strength factor score

Equity weighted score = 40% x the equity strength factor score

Net Income weighted score = 20% 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

RATIO	Computation	Strength Factor	Weight Factor	Composite Scores
Primary Reserve Ratio	0.361	3.00	40%	1.20
Equity Ratio	0.350	2.10	40%	0.84
Net Income Ratio	(0.0015)	0.9615	20%	0.19
				2.23
TOTAL Composite Score - Rounded				**2.2**