

APPENDIX B TO SUBPART L OF PART 668—RATIO METHODOLOGY FOR PRIVATE NON-PROFIT INSTITUTIONS

Section 1: Ratios and Ratio Terms

$$\text{Primary Reserve Ratio} = \frac{\text{Expendable Net Assets}}{\text{Total Expenses}}$$

$$\text{Equity Ratio} = \frac{\text{Modified Net Assets}}{\text{Modified Assets}}$$

$$\text{Net Income Ratio} = \frac{\text{Change in Unrestricted Net Assets}}{\text{Total Unrestricted Revenue}}$$

Definitions:

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 Expenses is total unrestricted expenses taken directly from the audited financial statement

Modified Net Assets = (unrestricted net assets) + (temporarily restricted net assets) + (permanently restricted net assets) - (intangible assets) - (unsecured related-party receivables)

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

Change in Unrestricted Net Assets is taken directly from the audited financial statement

Total Unrestricted Revenue is taken directly from the audited financial statement (This amount includes net assets released from restriction during the fiscal year)

* The value of plant, property and equipment is net of accumulated depreciation, 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.

Section 2. Calculating the Ratios from the Balance Sheet and Statement of Activities

| Line | Total | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|------|---|-------------------|------------------------|------------------------|-------------------|
| 1 | Cash and Cash Equivalents | \$ 1,000,000 | | | \$ 1,000,000 |
| 2 | Accounts Receivable | 6,000,000 | | | 6,000,000 |
| 3 | Prepaid Expenses | 1,500,000 | | | 1,500,000 |
| 4 | Inventories | 500,000 | | | 500,000 |
| 5 | Contributions Receivable | 2,000,000 | | | 2,000,000 |
| 6 | Student Loans Receivable | 8,000,000 | | | 8,000,000 |
| 7 | Investments | 6,000,000 | | | 6,000,000 |
| 8 | Property and Equipment, net | 50,000,000 | | | 50,000,000 |
| 9 | Bond Insurance Costs | 720,000 | | | 720,000 |
| 10 | Goodwill | 500,000 | | | 500,000 |
| 11 | Deposits | 20,000 | | | 20,000 |
| 12 | Total Assets | 76,240,000 | | | 76,240,000 |
| 13 | Line of Credit | \$ 500,000 | | | \$ 500,000 |
| 14 | Accounts Payable | 2,000,000 | | | 2,000,000 |
| 15 | Accrued Expenses | 3,500,000 | | | 3,500,000 |
| 16 | Deferred Revenue | 650,000 | | | 650,000 |
| 17 | Post-Retirement Benefits Liability | 6,600,000 | | | 6,600,000 |
| 18 | Bonds Payable | 36,000,000 | | | 36,000,000 |
| 19 | Total Liabilities | 49,250,000 | | | 49,250,000 |
| 20 | Unrestricted Net Assets | 15,190,000 | | | 15,190,000 |
| 21 | Annulities | 300,000 | | | 300,000 |
| 22 | John Doe Scholarship Fund | 2,500,000 | | | 2,500,000 |
| 23 | Total Temp. Restricted Net Assets | 2,800,000 | | | 2,800,000 |
| 24 | Permanent Restr. Net Assets | 9,000,000 | | | 9,000,000 |
| 25 | Total Net Assets | 26,990,000 | | | 26,990,000 |
| 26 | Total Liabilities & Net Assets | 76,240,000 | | | 76,240,000 |

| Line | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|------|---------------------------------------|------------------------|------------------------|-------------------|
| 27 | Tuition and Fees | \$45,000,000 | | \$45,000,000 |
| 28 | Contributions | 1,200,000 | \$ 300,000 | 1,620,000 |
| 29 | Auxiliary Enterprises | 5,500,000 | | 5,500,000 |
| 30 | Net Assets Released from Restrictions | 200,000 | | 200,000 |
| 31 | Total Revenue | 51,900,000 | 300,000 | 52,320,000 |
| 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 |
| 36 | Non-Operating Expenses | 900,000 | | 900,000 |
| 37 | Net Assets Released from Restrictions | | 200,000 | 200,000 |
| 38 | Total Expenses | 51,980,000 | 200,000 | 52,180,000 |
| 39 | Change in Net Assets | (80,000) | 100,000 | 140,000 |
| 40 | Net Assets at beginning of year | 15,270,000 | 2,700,000 | 18,000,000 |
| 41 | Net Assets at end of year | 15,190,000 | 2,800,000 | 18,000,000 |

Primary Reserve Ratio = (lines) $\frac{20+23-21-10-8+18}{38a} = \frac{\$ 9,790,000}{\$ 51,980,000} = 0.188$

Equity Ratio = (lines) $\frac{25-10}{12-10} = \frac{\$ 26,490,000}{75,740,000} = 0.350$

Net Income Ratio = (lines) $\frac{30a}{31a} = \frac{\$ (80,000)}{\$ 51,980,000} = (0.0015)$

* In accounting statements, parentheses denote negative numbers (i.e., (80,000) equals negative 80,000).

** Long-Term Debt (line 18) cannot exceed Property and Equipment, net (line 8) in this formula.

Section 3: Calculating the Composite Score

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

Example (for Private Non-Profit institutions)

$$10 \times 0.188 = 1.880$$

Primary Reserve strength factor score = $10 \times$ Primary Reserve ratio result:

$$6 \times 0.350 = 2.100$$

Equity strength factor score = $6 \times$ Equity ratio result:

Because the Net Income ratio result is negative, the algorithm for negative

net income is used -- Net Income strength factor score = $1 + (25 \times \text{Net Income ratio result}) = 0.963$

(Note: If the Net Income ratio result is positive, the following algorithm is used, Net Income strength factor score = $1 + (50 \times \text{Net Income ratio result})$ -- If the Net Income ratio result is 0, the Net Income strength factor score is 1).

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 = $40\% \times$ Primary Reserve strength factor score:

$$0.40 \times 1.880 = 0.752$$

Equity weighted score = $40\% \times$ Equity strength factor score:

$$0.40 \times 2.100 = 0.840$$

Net Income weighted score = $20\% \times$ Net Income strength factor score:

$$0.20 \times 0.963 = 0.193$$

Composite score = sum of all weighted scores:

$$0.752 + 0.840 + 0.193 = 1.785$$

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

$$1.8$$

* The symbol " \times " denotes multiplication.

[62 FR 62885, Nov. 25, 1997, as amended at 63 FR 40349, July 28, 1998. Redesignated at 65 FR 65650, Nov. 1, 2000]