§ 668.172 Financial ratios.

(a) Appendices A and B, ratio methodology. As provided under appendices A and B to this subpart, the Secretary determines an institution’s composite score by—

(1) Calculating the result of its Primary Reserve, Equity, and Net Income ratios, as described under paragraph (b) of this section;

(2) Calculating the strength factor score for each of those ratios by using the corresponding algorithm;

(3) Calculating the weighted score for each ratio by multiplying the strength factor score by its corresponding weighting percentage;

(4) Summing the resulting weighted scores to arrive at the composite score;

(5) Rounding the composite score to one digit after the decimal point.
(b) **Ratios.** The Primary Reserve, Equity, and Net Income ratios are defined under appendix A for proprietary institutions, and under appendix B for private non-profit institutions.

(1) The ratios for proprietary institutions are:

For proprietary institutions:

\[
\text{Primary Reserve ratio} = \frac{\text{Adjusted Equity}}{\text{Total Expenses}}
\]

\[
\text{Equity ratio} = \frac{\text{Modified Equity}}{\text{Modified Assets}}
\]

\[
\text{Net Income ratio} = \frac{\text{Income Before Taxes}}{\text{Total Revenues}}
\]

(2) The ratios for private non-profit institutions are:

For private non-profit institutions:

\[
\text{Primary Reserve ratio} = \frac{\text{Expendable Net Assets}}{\text{Total Expenses}}
\]

\[
\text{Equity Ratio} = \frac{\text{Modified Net Assets}}{\text{Modified Assets}}
\]

\[
\text{Net Income ratio} = \frac{\text{Change in Unrestricted Net Assets}}{\text{Total Unrestricted Revenues}}
\]

(c) **Excluded items.** In calculating an institution’s ratios, the Secretary—

(1) Generally excludes extraordinary gains or losses, income or losses from discontinued operations, prior period adjustments, the cumulative effect of changes in accounting principles, and the effect of changes in accounting estimates;

(2) May include or exclude the effects of questionable accounting treatments, such as excessive capitalization of marketing costs;

(3) Excludes all unsecured or uncollateralized related-party receivables;

(4) Excludes all intangible assets defined as intangible in accordance with generally accepted accounting principles; and

(5) Excludes from the ratio calculations Federal funds provided to an institution by the Secretary under program authorized by the HEA only if—

(i) In the notes to the institution’s audited financial statement, or as a separate attestation, the auditor discloses by name and CFDA number, the amount of HEA program funds reported as expenses in the Statement of Activities for the fiscal year covered by that audit or attestation; and

(ii) The institution’s composite score, as determined by the Secretary, is less than 1.5 before the reported expenses arising from those HEA funds are excluded from the ratio calculations.

(Approved by the Office of Management and Budget under control number 1840–0537)

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