



Dallas Theological Seminary
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**When FASB Reporting
Changes Collides with ED
Federal Regulations**




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Overview

- Title IV Financial Responsibility Standard
 - Common misapplication of ED regulations
- Recent FASB Changes: Impact on ED Ratios
- ED's Proposed Changes in Ratio Definitions
 - Now on hold – What's Next
- New eZ-Audit Instructions – not that eZ to understand
- What Accreditation Evaluators Want To See
- FASB Liquidity/Availability Measures – if time permits

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**Title IV Financial Responsibility
Standards**

- Must demonstrate financial health to participate in Title IV
 - Intended to guard against precipitous closure
 - Ensure adequate resources to provide education
- Three key ratios are calculated, weighted, and combined into a “composite score”
- Cover NFP and proprietary institutions with distinct definitions and formulas for each

Public institutions are exempt

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ED Fin Resp Score Ratios

Primary Reserve Ratio

- Measures if institution has financial resources to support its mission
- Evaluates whether financial reserves are sufficient to meet current and future operating commitments


Equity Ratio

- Captures institution's overall capitalization structure
- Measures amount of total resources financed by contributions or accumulated earnings

Net Income Ratio

- Provides a direct measure of institution's "profitability"
- Assesses college's ability to operate within its means

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Primary Reserve Ratio

$$\frac{\text{Expendable Net Assets}}{\text{Total Expenses}} \quad 40\%$$

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 = total unrestricted expenses taken directly from the audited financial statements

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Expendable Net Assets Total Expenses

Expendable Net Assets

- unrestricted net assets + temporarily restricted net assets


Subtract from net assets:

- - annuities, term endowments and life income funds that are temporarily restricted
- - intangible assets
- - unsecured related-party receivables
- - net property, plant and equipment

Add back to net assets

- + all debt obtained for long term purposes
- + post employment and retirement liabilities

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Equity Ratio

Modified Net Assets

Modified Assets


40%



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)

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Net Income Ratio

Change in Unrestricted Net Assets

Total Unrestricted Revenue


20%



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

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

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Composite Score Distribution

Scale ranges from -1.0 to 3.0 (not a ranking)


Fail	-1 to .9
Zone	1.0 to 1.4
Pass	1.5 to 3.0

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Composite Score Consequences

- **Zone alternative (1.0 - 1.4)**
Special disbursement requirements
Enhanced monitoring by ED
May remain “in the zone” for up to three years
- **Failing (below 1.0)**
Provisional certification
Must provide ED letter of credit for at least 10% of prior year Title IV funds



Letter of credit for 50% of prior year Title IV funds = Financially responsible

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ED Often Makes Adjustments

Item	What ED Does...	Ratio Result
TOTAL EXPENSES (RATIO DENOMINATOR)	Adds all types of losses: investment, pension plan changes, etc. is part of Total Expenses	Decreases primary reserve
LONG-TERM DEBT	Excludes long-term lines of credit, working capital loans, more	Decreases primary reserve
POST-EMPLOYMENT & RETIREMENT LIABILITIES	Excludes liability for D.B. pension benefits from definition of Retirement Liabilities	Decreases primary reserve
UNSECURED RELATED PARTY RECEIVABLES	Excludes pledges from board members as related-party receivables	Decreases equity and primary reserve
TEMPORARILY RESTRICTED NET ASSETS	Assumes all TRNA endowments are term endowments (time limits = non-expendable)	Decreases primary reserve
NET PPE	Subtracts construction-in-progress	Increases primary reserve
TOTAL UNRESTRICTED REVENUE	Inconsistently includes gains with revenue; but may net losses against revenue	Increases/decreases primary reserve

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What Difference Can This Make?

One Institution's Experience Total Assets: >\$1 billion Revenues: > \$700 million	Score with DOE Interpretation of Accumulated Gains, Pension Liability losses	Score with Institution's Interpretation of Accumulated Gains, Pension Liability losses	Amount Spent on Legal Costs and LOC while in conversation with DOE
FY 12	1.0	1.6	
FY 13	1.2	2.5	\$290,000
FY 14	0.9	2.2	386,000
FY 15	0.1	1.7	286,000
FY 16	0.0	1.6	110,000
FY 17	0.9	2.5	TBD
		Spent to date	\$1,072,000

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Financial Reporting Changes

▪ **FASB ASU 2016-14**

- Presentation of Financial Statements of Not-for-Profit Entities (Topic 958)
- Updates the current formulas used in calculating composite scores for nonprofit institutions.

▪ **FASB ASU 2016-2**

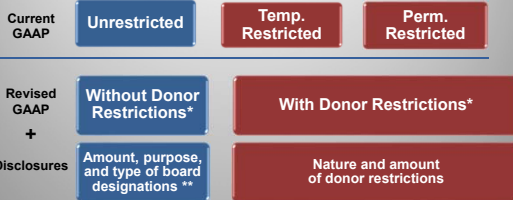
- Leases
- Right-of-Use Asset: PPE? Intangible Asset?
- What about related long term liabilities?

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ED Worries That Perm. Restricted Net Assets will Not Be Disclosed

Net Assets



* NFPs may choose to disaggregate further
 ** New disclosure requirement

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

Expendable Net Assets

- unrestricted net assets + temporarily restricted net assets

Subtract from net assets

- - annuities, term endowments and life income funds that are temporarily restricted
- - intangible assets
- - unsecured related-party receivables
- - net property, plant and equipment

Add back to net assets

- + post employment and retirement liabilities
- + all debt obtained for long term purposes

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Term Endowments – Not Expendable Net Assets

	Without donor restrictions	With donor restrictions		Total with donor restrictions	Total funds
		Original gift amount	Accumulated gains (losses) and other		
Donor-restricted funds	\$ -	\$ 38,044,381	\$ 8,056,900	\$ 46,101,281	\$ 46,101,281
Board-designated funds	651,618	-	-	-	651,618
	\$ 651,618	\$ 38,044,381	\$ 8,056,900	\$ 46,101,281	\$ 46,752,899

Term endowments, which total \$697,387 at June 30, 2018, are included in accumulated gains (losses) and other. Term endowments are gifts of cash and other assets with stipulations that they be invested to provide a source of income for a specified term and that the income be used for a specified purpose are both time and purpose restricted.

- ED defines "Term Endowments" to include accumulated gains
- This is then adjusted for 1 year of spending payout per August announcement.
- ED abandoned FASB's definition of Term Endowment after FASB issued FAS 117-1 Endowments Subject to UPMIFA (time restriction)

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Total Expense: Denominator Primary Reserve Ratio

	Year Ended June 30	
	2018	2017
CHANGES IN NET ASSETS WITHOUT DONOR RESTRICTIONS:		
Operating Revenues and Other Additions:		
Tuition and fees, net	\$ 16,660,146	\$ 13,556,092
Contributions	13,365,343	12,513,846
Investment return appropriated for spending	740,103	1,086,569
Educational activities and other income	739,560	786,917
Auxiliary enterprises	3,216,381	3,221,329
Total Operating Revenues	34,721,533	31,175,353
Net assets released from restrictions:		
Satisfaction of program restrictions	3,215,426	3,761,820
Appropriation from donor endowment and subsequent of any related donor restrictions	1,951,314	1,928,120
Total Operating Revenues and Other Additions	39,608,711	36,065,543
Expenses:		
Salaries and wages	17,492,033	17,047,765
Employee benefits	4,746,365	4,937,925
Services, supplies, and other	6,938,365	6,314,236
Occupancy, utilities, and maintenance	2,339,674	2,170,897
Grants to others	3,573,072	3,498,599
Depreciation and amortization	2,187,118	2,368,899
Interest	647,328	659,011
Operating Expenses	37,973,975	36,917,131
Change in Net Assets from Operations	1,964,318	1,928,700
Non-Operating Change in Net Assets Without Donor Restrictions:		
Net periodic pension cost other than service cost	(1,431,043)	(1,854,647)
Pension related changes other than net periodic pension costs	1,353,272	4,161,531
Investment return, net in excess of amounts appropriated for spending	(3,924)	(666,066)
Change in value of split-interest agreements	(83,452)	82,093
Change in Net Assets from Non-Operating Activities	(109,147)	1,783,520
Change in Net Assets Without Donor Restrictions	1,795,184	3,666,718

What is Total Expense?

Intermediate Measure of Operations
ED's Expense (losses) ????

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Total Expense

Total expenses include all operating expenses and the net periodic pension cost other than service cost.

	Program Activities			Supporting Activities			Total Expense
	Academic and Student Programs	Public Service	Auxiliary	Administrative Support	Facilities Operation & Maintenance	Fundraising	
Salaries and wages	\$ 11,405,845	\$ 326,706	\$ 661,771	\$ 2,941,560	\$ 940,031	\$ 1,236,120	\$ 17,492,033
Employee benefits	3,270,000	63,783	221,224	2,023,215	284,698	715,590	6,177,410
Services, supplies, and other	3,019,313	197,134	678,360	1,088,328	224,631	1,730,630	6,938,365
Occupancy, utilities, and maintenance	107,987	1,431	484,767	33,327	1,706,615	5,527	2,339,674
Grants to others	303,720	3,269,352	-	-	-	-	3,573,072
Depreciation and amortization	561,327	23,178	1,395,860	351,544	40,842	13,887	2,187,118
Interest	-	-	647,328	-	-	-	647,328
	18,669,292	3,881,624	3,689,359	6,435,974	3,196,617	3,282,154	39,355,020
Facilities operation and maintenance	2,686,403	93,180	207,198	669,155	(3,196,617)	140,476	-
Total expenses	\$ 20,355,700	\$ 3,975,004	\$ 4,096,557	\$ 7,105,129	\$ -	\$ 3,422,630	\$ 39,355,020

- ED would add to Total Expense all "losses"; includes investment losses, pension changes if negative and any other debits within non-operating section (without donor restrictions)

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ASU 2016-02 Leases

- Lessees should recognize a right-of-use asset and a lease liability for virtually all leases (Finance and Operating).
 - For Operating Leases
 - Term – not for a major part of remaining economic life (most will use ≤ 75%)
 - Present Value – not substantially all of the FV of underlying asset (most will use ≤ 90%)
- Will Negatively Impact the Equity Ratio

<u>Modified Net Assets</u>
<u>Modified Assets</u>
- An Increase in Modified Assets Lowers Equity Ratio
- ED intends to issue an announcement on treatment of leases

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ED Subcommittee for Financial Responsibility (Nov-Feb 2018)

- July 2018 Proposed Borrower Defense / Fin Resp Regulations
 1. Total Expense – clarified that it does not include investment losses or post-employment and DB Pension Plan losses. Does include Nonservice Component of Net periodic Cost
 2. Operating Lease liability considered part of long term debt
 3. Right-of Use Asset treated like Property Plant and Equip, net
 4. Defined Benefit Pension Liabilities treated as retirement liabilities
 5. Board pledges treated as secured related party receivables
 6. Construction in progress is part of PP&E
 7. Supplemental Schedule to report Perpetually Restricted Net Assets and all components used in calculating ratios
- ED missed Oct 1, 2018 deadline – No Changes Forthcoming

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If No Change to Regulations What Now?

- Instructions for Not-for-Profit Institutions to Input Financial Statement Data into the eZ-Audit System Due to Changes Resulting from ASU 2016-14
 - IFAP Electronic Announcement August 29, 2018
- eZ-Audit System has not yet been updated to reflect changes to Accounting Standards
- Instructions given to facilitate transition
- <https://ifap.ed.gov/eannouncements/082918Inst4Not4ProfitInstinputFinStateDateeZAuditSys.html>

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