Standards of Financial Responsibility

NASFAA Conference July 1998

Components of Financial Responsibility

- Financial obligations
- Administration of SFA Programs
- Financial health

Objectives for New Regulations

- To provide an overall measure of a school's financial health.
- To establish an approach that allows financial strength in one area to mitigate financial weakness in another area.
- To reflect more accurately the differences between non-profit and for-profit schools.
- To provide a way to evaluate the financial health of schools along a common scale.

Scoring Scale

- Composite scores range from -1 to +3
- A school with a composite score of 1.5 or higher is able to participate without additional oversight.
- The Department may allow a school with a composite score of less than 1.0 to participate under alternative standard.
- A school in the "zone" (1.0 to 1.4) may participate with additional oversight but without a letter of credit or provisional certification.

Cash Monitoring

- A payment method that provides the Department a way to monitor SFA funds in a way less burdensome than by reimbursement.
- Two types of cash monitoring.

  (1) School draws funds after making disbursements.

  (2) School requests funds for disbursements made but case teams have flexibility to tailor documentation to specific case.

Measuring Financial Health

- Broad Perspective of Financial Health
- Minimum Strength (12-18 months)
- Ratios used to determine Financial Health/Risk

Why Financial Ratios?

- Relationship between two numbers.
- Offer a capsulated view of key conditions.
  - provide insight into specific elements of financial health.
- Viewed together, provide efficient means for assessing an institution's overall financial condition.
- Eliminate disparity between F/S size.

Elements of Financial Health

- Viability, Liquidity (Primary Reserve Ratio)
- Profitability (Net Income Ratio)
- Ability to Borrow, Capital Resources (Equity Ratio)

Measuring Financial Health - Proprietary Institution Ratios

$$\text{Primary Reserve Ratio} = \frac{\text{Adjusted Equity}}{\text{Total Expenses}}$$

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

$$\text{Net Income Ratio} = \frac{\text{Income Before Taxes}}{\text{Total Revenues}}$$

Measuring Financial Health - Private Non-Profit Institution Ratios

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

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

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

Public Institutions

A composite score is not applied to the financial statements of a public institution. In order to be considered by the Department as a "public" institution:

- The public institution must provide to the Department a letter from an official of the applicable governmental unit confirming that the institution is public.
- The institution must not be in violation of any past performance requirements.

Calculating Composite Score for a Proprietary School

Step 1: Calculate the ratios	Step 2: Calculate strength factor score	Step 3: Calculate weighted score
Primary Reserve = .06	.06X20 = 1.2	1.20 X 30% = 0.36000
Equity Ratio = .27	.27X6=1.620	1.620 X 40% = 0.64800
Net Income Ratio = .029	(.029X33.3)+1 = 1.9657	1.9657X30% = 0.58971

Step 4: Add the weighted scores and round to one digit after decimal point **1.59771 = 1.6**

Composite Score Grading Scale

-1.0 1.0 1.5 3.0

Failed Financial Responsibility Standards	With Conditions	Passed Financial Responsibility Standards
FAIL	**ZONE**	**PASS**
OPTIONS: **Post a Minimum 50% LOC** **Provisional Certification** [Minimum 10% LOC and Cash Monitoring level 1 or 2, or reimbursement]	Cash Monitoring or Reimbursement Based on Case Team Risk Assessment OPTIONS: CM Level 1 CM Level 2 Reimbursement and/or other reporting as required by case team	No Requirements

Document Receipt & Control Center

- Receives all financial statements.
- Calculates ratios.
- Assesses economic viability and unusual accounting treatments or policies.
- Maintains files.

Document Receipt & Control Center

Forwards financial statements to Case Management teams -

- Upon request of teams.
- If composite score is below 1.5

DRCC Address

- ***If by U.S. Postal Service:***

  U.S. Department of Education, IPOS
  P.O. Box 44805
  L'Enfant Plaza Station
  Washington, DC 20026-4805

- ***If by commercial overnight or courier delivery:***

  U.S. Department of Education, IPOS
  7th & D Streets, SW
  GSA Building, Room 3514
  Washington, DC 20407

Case Management

- Obtains any letters of credit (LOC).
- Administers reimbursement & cash monitoring.
- Reviews financial statements on a case-by-case basis.

Transition Year

- The “transition year” is the fiscal year that begins between July 1, 1997 and June 30, 1998, inclusive.
- Applies if composite score is less than 1.5

Questions and Answers

- Website located at:

http://www.ed.gov/offices/OPE/PPI/finanrep.html

Disclaimer

- We reserve the right to apply the requirements in ways that best serve students, institutions and taxpayers consistent with the laws and regulations.