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Below is the methodology used by the U.S. Department of Education to determine the financial composite score for proprietary and non-profit institutions. Please use these formulas to use the calculation worksheet.

### **Ratio Methodology for Proprietary Institutions**

Note: Appendix added November 25, 1997, effective July 1, 1998

#### Section 1: Ratios and Ratio Terms

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

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

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

#### Definitions:

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

Total Expenses excludes income tax, discontinued operations, extraordinary losses, or change in accounting principle.

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

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

Income Before Taxes is taken directly from the audited financial statement

Total Pre-Tax Revenues = (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 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 Income Statement Balance

*Note: Due to formatting limitations we were unable to reproduce the tables for the Balance Sheet and the State of Income and Retained Earnings. Please refer to the General Printing Office's published 34 CFR 668 through 7/1/02 for this information*

### Section 3: Calculating the Composite Score

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

#### Example (for Proprietary Institutions)

Primary Reserve strength factor score =  $20 \times$  Primary Reserve ratio result:  
 $20 \times 0.080 = 1.600$

Equity strength factor score =  $6 \times$  Equity ratio result:  
 $6 \times 0.332 = 1.992$

Net Income strength factor score =  $1 + (33.3 \times$  Net Income ratio result):  
 $1 + (33.3 \times 0.051) = 2.698$

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 =  $30\% \times$  Primary Reserve strength factor score:  
 $0.30 \times 1.600 = 0.480$

Equity weighted score =  $40\% \times$  Equity strength factor score:  
 $0.40 \times 1.992 = 0.797$

Net Income weighted score =  $30\% \times$  Net Income strength factor score:  
 $0.30 \times 2.698 = 0.809$

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

## **Ratio Methodology for Private Non-Profit Institutions**

Note: Appendix added November 25, 1997, effective July 1, 1998

### 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.

*Note: Definition of Expendable Net Assets amended July 28, 1998, effective July 1, 1998.*

### **Section 2: Calculating the Ratios from the Balance Sheet and Statement of Activities**

*Note: Due to formatting limitations we were unable to reproduce the tables for the Balance Sheet and the State of Income and Retained Earnings. Please refer to the General Printing Office's published 34 CFR 668 through 7/1/02 for this information*

### 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)

Primary Reserve strength factor score =  $10 \times$  Primary Reserve ratio result:  
 $10 \times 0.188 = 1.880$

Equity strength factor score =  $6 \times$  Equity ratio result:  
 $6 \times 0.350 = 2.100$

Because the Net Income ratio result is negative, the algorithm for negative net income is used—

Net Income strength factor score =  $1 + (25 \times$  Net Income ratio result):  
 $1 + (25 \times -0.0015) = 0.963$

(Note: If the Net Income ratio result is positive, the following algorithm is used, Net Income strength factor score =  $1 + (50 \times$  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:  $.752 + 0.840 + 0.193 = 1.785$

Round the composite score to one digit after the decimal point to determine the final score: 1.8



## Private Non-Profit School Financial Composite Score Calculation Worksheet

Schools shall be exempt from the surety instrument requirement if they can demonstrate a U.S. Department of Education composite financial responsibility score of 1.5 or greater on their current audited or reviewed financial statement; or if they can demonstrate a composite score between 1.0 and 1.4 on their current audited or reviewed financial statement and have scored at least 1.5 on an audited or reviewed financial statement in either of the prior two years. The Worksheet below can be used to assist the school with the calculation of a composite score.

### STEP ONE: Calculate the Ratio

Ratio	Formula	Result
Primary Reserve Ratio	$\frac{\text{Expandable Net Assets}}{\text{Total Expenses}}$	
Equity Ratio	$\frac{\text{Modified Net Assets}}{\text{Modified Assets}}$	
Net Income Ratio	$\frac{\text{Change in Unrestricted Net Assets}}{\text{Total Unrestricted Assets}}$	

### STEP TWO: Calculate the Strength Factor Score

Primary Reserve Strength Factor Score = 10 X Primary Reserve Ratio Result*	Result:
Equity Strength Factor Score = 6 X Equity Ratio Result*	Result
Net Income Strength Factor Score = (IF NET INCOME RATIO IN STEP ONE IS POSITIVE), use this formula: 1 + (50 X Net Income Ratio Result) (IF THE NET INCOME RATIO IN STEP ONE IS 0) then the Strength Factor Score = 1 (IF THE NET INCOME RATIO IN STEP ONE IS NEGATIVE), use this formula: 1 + (25 X Net Income Ratio Result)*	Result:

\* Note: If the strength factor for any ration 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 to -1, the strength factor score for that ration is -1.

### STEP THREE: Calculate the Weighted Score

Primary Reserve Weighted Score = 40% X Primary Reserve Strength Factor Score	Result:
Equity Weighted Score = 40% X Equity Strength Factor Score	Result
Net Income Weighted Score = 20% X Net Income Strength Factor Score	Result:

### STEP FOUR: Calculate the Composite Score

Sum of ALL Weighted Scores in STEP THREE above: \_\_\_\_\_

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

### Financial Responsibility Composite Score Scale:

1.5 – 3.0	Institution demonstrates overall financial health
1.0 – 1.4	Institution demonstrates minimal financial health; additional monitoring is needed in the areas of viability, liquidity and/or profitability.
-1.0 - .9	Institution demonstrates relative weakness in fundamental elements of financial health; i.e. viability, liquidity and/or profitability.



## Proprietary School Financial Composite Score Calculation Worksheet

Schools shall be exempt from the surety instrument requirement if they can demonstrate a U.S. Department of Education composite financial responsibility score of 1.5 or greater on their current audited or reviewed financial statement; or if they can demonstrate a composite score between 1.0 and 1.4 on their current audited or reviewed financial statement and have scored at least 1.5 on an audited or reviewed financial statement in either of the prior two years. The Worksheet below can be used to assist the school with the calculation of a composite score.

### STEP ONE: Calculate the Ratio

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

### STEP TWO: Calculate the Strength Factor Score

Primary Reserve Strength Factor Score = $20 \times \text{Primary Reserve Ratio}^*$	<b>Result:</b>
Equity Strength Factor Score = $6 \times \text{Equity Ratio}^*$	<b>Result:</b>
Net Income Strength Factor Score = $1 + (33.3 \times \text{Net Income Ratio})^*$	<b>Result:</b>

\* Note: If the strength factor for any ration 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 to -1, the strength factor score for that ration is -1.

### STEP THREE: Calculate the Weighted Score

Primary Reserve Weighted Score = $30\% \times \text{Primary Reserve Strength Factor Score}$	<b>Result:</b>
Equity Weighted Score = $40\% \times \text{Equity Strength Factor Score}$	<b>Result:</b>
Net Income Weighted Score = $30\% \times \text{Net Income Strength Factor Score}$	<b>Result:</b>

### STEP FOUR: Calculate the Composite Score

Sum of ALL Weighted Scores in STEP THREE above: _____
<i>Round the composite score to one digit after the decimal point to determine the final score</i>

### Financial Responsibility Composite Score Scale:

1.5 – 3.0	Institution demonstrates overall financial health
1.0 – 1.4	Institution demonstrates minimal financial health; additional monitoring is needed in the areas of viability, liquidity and/or profitability.
-1.0 - .9	Institution demonstrates relative weakness in fundamental elements of financial health; i.e. viability, liquidity and/or profitability.