

7. A new Appendix F is added to read as follows:

Appendix F: Ratio Methodology for Proprietary Institutions
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 revenues 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 Sheet

Line		
1	Cash	\$ 190,000
2	Accounts Receivable	1,010,000
3	Prepaid Expenses	150,000
4	Inventories	130,000
5	Note Receivable from Affiliate	200,000
6	Investments	330,000
7	Total Current Assets	2,010,000
8	Property and Equipment, net	500,000
9	Amount Due from Owner	170,000
10	Goodwill	80,000
11	Organization Costs	70,000
12	Deposits	60,000
13	Total Assets	2,890,000
14	Accounts Payable	200,000
15	Accrued Expenses	330,000
16	Current Portion of Long-Term Debt	120,000
17	Deferred Revenue	650,000
18	Total Current Liabilities	1,300,000
19	Long-Term Debt, net of Current Portion	330,000
20	Total Liabilities	1,630,000
21	Contributed Capital	440,000
22	Retained Earnings	820,000
23	Total Owner's Equity	1,260,000
24	Total Liabilities and Owner's Equity	2,890,000

Statement of Income and Retained Earnings

Line		
25	Operating Income	\$ 9,700,000
26	Non-Operating Income	300,000
27	Total Income	10,000,000
28	Cost of Goods Sold	6,800,000
29	Administrative Expenses	2,600,000
30	Depreciation Expense	60,000
31	Interest Expense	40,000
32	Total Expenses	9,500,000
33	Other: Gain on Sale of Investments	10,000
34	Net Income Before Taxes	510,000
35	Federal Income Taxes	153,000
36	Net Income After Taxes	357,000
37	Extraordinary Loss, net of tax	800,000
38	Net Income	(443,000)
39	Retained Earnings, beginning of year	1,263,000
22	Retained Earnings, end of year	820,000

$$\text{Primary Reserve} = (\text{lines } 23-5-9-10-8 + (16+19)) \div 32 = \frac{\$760,000}{\$9,500,000} = 0.080$$

$$\text{Equity Ratio} = (\text{lines } 23-5-9-10) \div (13-5-9-10) = \frac{\$810,000}{\$2,440,000} = 0.332$$

$$\text{Net Income} = (\text{lines } 34) \div (27+33) = \frac{\$34}{\$10,010,000} = 0.051$$

*Long-Term Debt (lines 16 + 19) cannot exceed Property and Equipment (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 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 = $1 + (33.3 \times \text{Net Income ratio result})$: $1 + (33.3 \times 0.051) = 2.698$

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

* The symbol "x" denotes multiplication.