

ED's New Audit Guide & 90/10 Compliance

September 27, 2017

As with many other areas of financial aid management discussed in our prior posts, the audit requirements relating to compliance with the "90/10 Rule" have increased significantly in [ED's new Audit Guide](#). These new requirements, applicable to the audited financial statements of proprietary institutions for fiscal years ending June 30, 2017 or later, include the institution's obligation to perform the 90/10 revenue calculation rather than the auditor calculating it, the auditor's responsibility to report any calculation misstatement as an internal control finding, required procedures to assist the auditor in identifying "schemes to manipulate" the 90/10 revenue calculation, and expanded disclosures in the financial statement notes.

Methodological Clarifications and Potential Impact

Under the new Audit Guide, institutions are required to perform the 90/10 calculations themselves, rather than relying on their auditor to complete the calculations from institution-provided data. This Audit Guide directive focuses the financial statement auditor's attention more squarely on testing the reliability and accuracy of the institution's data, including evaluation of source documents.

The new Audit Guide also clarifies unambiguously that institutions must determine and sum student Title IV and non-Title IV revenue on a *student by student* basis. This approach can have a major impact on how to classify revenue for students who, among other things, have "carry-over credit balances" from one fiscal year to another or receive large stipends in multiple years.

Taken together, the importance of these two clarifications becomes particularly pronounced since auditors are now directed to disclose *any* instance in which they conclude that an institution's 90/10 calculation is incorrect or misstated in *any* amount. Furthermore, the Audit Guide provides that each such instance must be reported as a finding in the auditor's financial statement report on internal controls over financial reporting. It is not yet clear how auditors will present or ED will review the additional findings that this requirement will trigger, but any finding that raises a question about the institution's internal controls is potentially problematic.

Detailed Testing Requirements and Materiality

Additionally, the new Audit Guide provides an expansive set of required audit procedures. Although the 90/10 calculation itself has not changed, instructions for testing provide clarification and, in some cases, are designed to smoke out "schemes to manipulate the 90/10 calculation" (ED's wording). The Audit Guide specifically directs auditors to evaluate the validity of transactions at the end of a fiscal year to determine if revenue is being counted in the correct year, the propriety of non-Title IV revenues from activities conducted by the school that are considered necessary for education and training, and institutional efforts that may be intended to steer students toward private loans rather than federal loans. In addition, the Audit Guide articulates several factors that it labels as "indications" that revenue from non-eligible programs is being improperly counted as Ten Revenue, providing insight into ED interpretations that have not been published previously for general readers.

Not surprisingly, the Audit Guide also emphasizes the heightened importance of these procedures when the institution's Title IV revenues are near the 90% maximum.

Expanded Note to Financial Statements

Audited financial statements prepared under the new Audit Guide are now required to include an expanded 90/10 disclosure in a note to the financial statements. In addition to the elements of the former note disclosure – which included the 90/10 revenue percentage, the dollar amount of the numerator and denominator used to calculate the percentage, and a brief explanatory note – the new note disclosure must provide further detail in chart form regarding how the various dollar amounts were derived. In addition, there are two important new line items in the note. First, Title IV revenue adjustments must include a line item for reductions based on Title IV refunds due based on a student's withdrawal. Second, revenue from other sources must include a line item for allowable student payments plus allowable amounts from accounts receivable or institutional loan sales, minus any required payments under a recourse agreement.

Although the expanded note requirements do not necessarily reflect significant substantive changes to the 90/10 calculations, the change in placement highlights the general theme of the Audit Guide, which is a requirement for more detailed and rigorous testing by the auditor. In practice, we expect that all of these changes mean that ED's financial analysts will focus more closely on identifying anomalies and any dramatic or possibly exaggerated changes in particular categories of Ten Revenue from year to year, which might result in inquiries or increased scrutiny for institutions.

Institutions are well advised to begin preparing for their financial statement audit as soon as possible, not only to ensure compliance under the more detailed 90/10 testing procedures, but also to allow sufficient time to perform the calculation before the auditors arrive. With the possibility that any difference between the institution's calculation and the auditor's opinion could lead to a finding – no matter how minor the variance – it is more important than ever to ensure precision in calculating and supporting the 90/10 revenue percentage.

As always, please do not hesitate to contact us if you would like to discuss any aspect of your financial statement or compliance audits under the new Audit Guide. You may also read our previous posts concerning other specific requirements of the new ED Audit Guide, including the [incentive compensation rules](#); [gainful employment compliance](#); [increased student samples, student confirmations and site visits](#); [Clery Act campus crime and security requirements](#); and [third-party servicers](#).

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