RD AN No. 3922 (4279-B)
November 28, 2003

SUBJECT: Business and Industry Guaranteed Loan Program
Calculation of Tangible Balance Sheet Equity

TO: State Directors, Rural Development

ATTN: Business Programs Directors

PURPOSE/INTENDED OUTCOME:

Several Rural Development State Offices have requested clarification on how to calculate tangible balance sheet equity to ensure compliance with the equity requirements contained in RD Instruction 4279-B, section 4279.131(d). Pursuant to section 4279.131(d), tangible balance sheet equity is to be determined in accordance with Generally Accepted Accounting Principles (GAAP). The purpose of this Administrative Notice (AN) is to provide the requested clarification.

COMPARISON WITH PREVIOUS AN:

This AN replaces and updates RD AN No. 3752, which expired on April 30, 2003.

DEFINITIONS:

APPRAISAL SURPLUS - the difference between the current market value of an asset and its depreciated book value, when the market value is higher. GAAP requires assets to be reflected at the lower of cost or market value on a balance sheet.

INTANGIBLE ASSETS – a non-current asset having no physical substance. Intangible assets can be calculated by deducting tangible assets from total assets. Examples of intangible assets include, but are not limited to, goodwill, copyrights, franchises, licenses,

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November 30, 2004

FILING INSTRUCTIONS:
Preceding RD Instruction 4279-B

trademarks, patents, mailing lists, subscription lists, contracts, and proprietary rights. For further guidance, see the attachment to this AN which provides a non-exclusive list of intangible assets.

Total Assets – Tangible Assets = Intangible Assets

SUBORDINATED DEBT – debt that is junior in claim on assets to other debt.

TANGIBLE ASSETS – an asset having physical substance. Tangible assets can be calculated by subtracting intangible assets from total assets. A non-exclusive list of examples is provided in the attachment to this AN.

Total Assets – Intangible Assets = Tangible Assets

TANGIBLE STOCKHOLDER’S EQUITY – tangible assets minus total liabilities or stockholder’s equity minus intangible assets.

TOTAL ASSETS – The sum of the business’ assets.

TOTAL LIABILITIES – The sum of the business’ debts.

TANGIBLE BALANCE SHEET EQUITY – tangible stockholder’s equity divided by tangible assets.

Formula 1:

$$\frac{\text{Tangible Stockholder's Equity}}{\text{Tangible Assets}} = \text{Tangible Balance Sheet Equity}$$

Since Tangible Stockholder’s Equity is equal to Tangible Assets minus Total Liabilities, this formula can be rewritten as:

Formula 2:

$$\frac{\text{Tangible Assets} - \text{Total Liabilities}}{\text{Tangible Assets}} = \text{Tangible Balance Sheet Equity}$$

or, using the Stockholder’s Equity minus Intangible Assets definition, this formula can be rewritten as:

Formula 3:

$$\frac{\text{Stockholder's Equity} - \text{Intangible Assets}}{\text{Tangible Assets}} = \text{Tangible Balance Sheet Equity}$$

NOTE: A non-exclusive list of examples of assets, liabilities, and equity is provided in the attachment to this AN. The above definitions are intended as guidance for those participating in our Business and Industry (B&I) Guaranteed Loan Program and, with the exception of tangible balance sheet equity and tangible stockholder's equity, are not intended to deviate from GAAP.

IMPLEMENTATION RESPONSIBILITIES:

GENERAL

RD Instruction 4279-B, section 4279.131(d), requires tangible balance sheet equity of 10 percent for existing businesses and 20 percent for new businesses determined in accordance with GAAP. Tangible balance sheet equity reflects the owners' investment in the tangible assets of the business. For startup businesses, tangible balance sheet equity should be calculated from pro forma startup balance sheets. **You are to obtain a certification from lenders that tangible balance sheet equity was calculated in accordance with and from financial statements prepared in accordance with GAAP.**

SUBORDINATED DEBT AND APPRAISAL SURPLUS

Subordinated debt and appraisal surplus may not be used to meet Agency equity requirements. In order to avoid appraisal surplus, assets must be listed at the lower of cost or market value. If the assets have appreciated over time, they must be listed on the balance sheet at cost value. Any improvements to the assets, at cost, may be included.

SOLE PROPRIETORSHIPS

Sole proprietorships, which often submit personal financial statements instead of balance sheets, often intermingle personal and business assets in their application. However, RD Instruction 4279-B, section 4279.131(d), requires the business, versus the individual, to have the requisite Tangible Balance Sheet Equity. Therefore, you can only count assets and liabilities directly attributable to the business in determining Tangible Balance Sheet Equity. Additionally, personal financial statements list assets at market values. When separating the business assets from personal assets, the business assets must be valued at the lower of cost or market value before calculating Tangible Balance Sheet Equity.

EXAMPLES

Scenario 1. The balance sheet reflects \$100,000 in tangible assets, \$80,000 in liabilities, and \$20,000 in equity, Tangible Balance Sheet Equity would be calculated as follows:

$$\frac{\text{Tangible Stockholder's Equity}}{\text{Tangible Assets}}$$

Since “Tangible Stockholder’s Equity” is defined as “Tangible Assets minus Total Liabilities” in the definitions above, it can be substituted in this formula as follows:

$$\frac{\text{Tangible Assets} - \text{Total Liabilities}}{\text{Tangible Assets}}$$

Since all of these numbers are known from the balance sheet, they can be inserted into the formulas as follows:

$$\frac{\$100{,}000 - \$80{,}000}{\$100{,}000}$$ which simplifies to 20 percent.

Scenario 2. Assume the same facts as Scenario 1, except $10,000 of the total assets are intangible, now tangible assets would be calculated as follows:

Tangible Assets = Total Assets – Intangible Assets = $100,000 - $10,000 = $90,000.

Using the second formula for calculating Tangible Balance Sheet Equity results in the following calculation:

$$\frac{\text{Tangible Assets} - \text{Total Liabilities}}{\text{Tangible Assets}} = \frac{\$90{,}000 - \$80{,}000}{\$90{,}000} = 11.1 \text{ percent}$$

You can take an interim balance sheet and adjust it to reflect the impact of the loan and its uses by adding in assets acquired and the resulting debt. Then you can calculate the impact of the loan on Tangible Balance Sheet Equity. This will give you an estimate of the Tangible Balance Sheet Equity assuming no losses or profits from the date of the interim statement until Loan Note Guarantee issuance.

Scenario 3. Assume the same facts of Scenario 2 and that a loan has been requested for $50,000 to buy new equipment, total assets and liabilities would increase by $50,000 each, and, therefore, stockholder’s equity would remain unchanged. Using the second formula for calculating Tangible Balance Sheet Equity results in the following calculation:

$$\frac{\text{Tangible Assets} - \text{Total Liabilities}}{\text{Tangible Assets}} = \frac{(\$90{,}000 + \$50{,}000) - (\$80{,}000 + \$50{,}000)}{(\$90{,}000 + \$50{,}000)} =$$

$$\frac{\$140{,}000 - \$130{,}000}{\$140{,}000} = 7.1 \text{ percent}$$

As you can see, this results in an insufficient percent of Tangible Balance Sheet Equity. As demonstrated in the next scenario, one solution, assuming this is an existing business, would be to decrease the loan amount by $4,000 and require a tangible asset contribution of the same amount.

Scenario 4. Assume the same facts as Scenario 3, but with the loan reduced by $4,000 and a tangible equity contribution of $4,000 by the applicant, tangible assets would stay the same (the $4,000 loss in loan proceeds to purchase equipment would be replaced by the applicant's additional $4,000 contribution to stockholder's equity). Since the B&I loan will be $4,000 less, total liabilities will be reduced accordingly. Then using the second formula for calculating Tangible Balance Sheet Equity results in the following calculation:

$$\frac{\text{Tangible Assets – Total Liabilities}}{\text{Tangible Assets}} = \frac{\$140{,}000 – (\$130{,}000 - \$4{,}000)}{\$140{,}000}$$

$$\frac{\$140{,}000 - \$126{,}000}{\$140{,}000} = \text{10 percent.}$$

If you have any questions, please contact the Business and Industry Division directly, (202) 690-4103.

(Signed by John Rosso)

JOHN ROSSO
Administrator
Rural Business-Cooperative Service

Attachment

ASSETS	CURRENT	NONCURRENT	INTANGIBLE
Accounts Receivable			
Trade (less reserves)	X		
From Affiliate			X
From Directors			X
From Employees			X
From Officers			X
From Partners			X
From subsidiary			X
Miscellaneous and other		X	
Advances			
For Merchandise	X		
For Mining Royalties		X	
For Traveling		X	
To Affiliate or Subsidiary		X	
To Employees		X	
Advertising			X
Automobiles		X	
Bond Discount			X
Bonds	X		
Bookplates			
At Cost			X
Metal Value		X	
Bottling Rights			X
Brands, Trade			X
Building and Loan Shares	X		
Buildings		X	

	CURRENT	NONCURRENT	INTANGIBLE
Cash			
In Bank	X		
In Closed Bank		X	
In Sinking Fund		X	
On Hand	X		
Restricted		X	
Cash Value of Life Insurance		X	
Catalogs			X
Claims for refunds under carry back provisions of Tax Law	X		
Coal Lands		X	
Contracts			X
Copyrights			X
Customer Lists			X
Debenture Discount			X
Deferred Charge			X
Deficit (profit and loss)			X
Delivery Equipment		X	
Deposits With Factor	X		
Deposits With Mutual Ins. Co.		X	
Deposits With Workman’s Comp. Commission		X	
Designs			X
Development Expense			X
Dies (at cost)		X	
Docks		X	
Drawings			X

ASSETS	CURRENT	NONCURRENT	INTANGIBLE	*For leasehold improvements to count as tangible assets, the lease must be a capital lease. i.e., long-term, lessee retains asset at the end of lease, etc.	CURRENT	NONCURRENT	INTANGIBLE
Emergency Plant Facilities		X		Loan to Affiliate			X
Equipment		X		Loan to Subsidiary			X
Experimental Expense			X	Machinery		X	
Exploration Expense			X	Magazine Titles			X
Financing Expense			X	Mailing Lists			X
Fixtures		X		Maintenance materials & parts		X	
Formulas			X	Marketable Securities	X		
Franchises			X	Merchandise (see Inventory)			
Furniture		X		Mines		X	
Goodwill			X	Miscellaneous Receivables		X	
Improvements		X		Models			X
Insurance Deposits		X		Mortgages Receivables		X	
Insurance Premiums, Prepaid	X			Municipal Bonds	X		
Interest, Accrued		X		Municipal Bonds in Default		X	
Inventory				Notes Receivable (Same as			
Advances on Merchandise	X			Accounts Receivable)			
Finished Goods	X			Organization Expense			X
In Transit	X			Packaging and Shipping Items		X	
On Consignment	X			Patents			X
Raw Materials	X			Patterns			X
Supplies		X		Pension Funds		X	
Work in Process	X			Plant		X	
Investments		X		Prepaid			
Investments in and advances				Insurance	X		
to subsidiaries & affiliates			X	Rent	X		
Land		X		Royalties	X		
Lasts			X	Supplies	X		
Leasehold Improvements *		X		Taxes	X		
Leaseholds			X	Processes			X
Licenses			X	Property		X	
Life Ins. Cash Surrender Value		X		Quarries		X	
Limited Securities	X			Real Estate		X	

ASSETS	CURRENT	NONCURRENT	INTANGIBLE		CURRENT	NONCURRENT	INTANGIBLE
Research Expense			X	Tools		X	
Revenue Stamps	X			Tracings			X
Rights, Publishing			X	Trade Acceptances	X		
Royalty, Prepaid		X		Trade Brand			X
Securities		X		Trademarks			X
Ships		X		Trade Name			X
Sight Drafts Outstanding	X			Treasury Bonds		X	
Sinking Fund		X		Trucks		X	
State Bonds	X			Unamortized mortgage or bond expense			X
Stock Subscription			X	U.S. Government Securities			X
Subscription Lists			X	Unlisted Securities**	X		
Timber (standing or uncut)		X		Vessels		X	

****Footnote**: Securities listed on National security exchange or having an active over-the-counter market may be classified as current if readily marketable and valued not in excess of market. Other securities, except Federal and State bonds, should be classified as non-current.

LIABILITIES & EQUITY	CURRENT	NONCURRENT	EQUITY
Accounts Payable			
For Merchandise	X		
For Services	X		
To Directors	X		
To Employees	X		
To Officers	X		
To Partners	X		
To Related Concerns	X		
Sundry	X		
Accruals			
Commission	X		
Interest	X		
Other Expenses	X		
Payroll	X		
Rent	X		
Salaries	X		
Taxes	X		
Wages	X		
Advances from Customers	X		
Bills Payable (same as			
Notes Payable)			
Bonds			
Amount maturing w/in 1 yr.	X		
Amount maturing after 1 yr.		X	
No Definite Maturity Date	X		
Capital (if partnership or			
proprietorship)			X
Capital Stock			
A, B, C Stock			X
Common Stock			X
Minority Interest		X	
Preferred Stock			X

	CURRENT	NONCURRENT	EQUITY
Capital Surplus			X
Chattel Mortgage		X	
Common Stock			X
Conditional Bill of Sale	X		
Contracts Payable	X		
Credit Balance	X		
Debentures			
Amount maturing w/in 1 yr.	X		
Amount maturing after 1 yr.		X	
Deferred Credits or Income		X	
Deferred Income	X		
Deposits			
From Customers	X		
From Employees	X		
From Officers	X		
From Salesman	X		
Depreciation (deduct from			
Related Assets)		X	
Dividends Payable	X		
Donated Surplus		X	
Due Factor	X		
Earned Surplus		X	
Employees' Deposits	X		
Federal Income Taxes	X		
Funded Debt			
Amount maturing w/in 1 yr.	X		
Amount maturing after 1 yr.		X	
Income Taxes	X		
Loans from Factor	X		
Loans Payable (same as			
Notes Payable)			
Minority Interest		X	

LIABILITIES AND EQUITY	CURRENT	NONCURRENT	EQUITY		CURRENT	NONCURRENT	EQUITY
Mortgages				Self-Insurance		X	
Amount maturing w/in 1 yr.	X			Taxes	X		
Amount maturing after 1 yr.		X		Unexpired Subscriptions		X	
Net Worth			X	Unrealized Profit		X	
Notes Payable				Salaries	X		
For Merchandise	X			Salesman's Deposits	X		
To Individuals	X			Sales Lien	X		
To Banks	X			Separation Allowances	X		
To Others	X			Social Security Taxes	X		
To Partners	X			Stock			X
To Stockholders	X			Stock Subscriptions	X		
Term Loans (same as Bonds)	X			Subordinated Debentures			
Officers' Deposits	X			(same as Debentures)	X		
Paid-in-Surplus			X	Sundry Accounts Payable	X		
Preferred Stock			X	Surplus Account			
Profit and Loss (deficit)			X	Capital Surplus			X
Provision for Income Taxes	X			Deficit (deduct)			X
Rent, Unpaid	X			Donated			X
Reserves				Earned			X
Bad Debts (deduct from A/R)				Paid-in			X
Contingencies		X		Profit/Loss			X
Depletion (deduct from				Surplus			
Related Assets)				From Undivided Profits			X
Discounts (deduct from A/R)				Taxes, unpaid	X		
Inventory Adjustments				Taxes, Withheld at Source	X		
(deduct from Related				Term Loans (same as Bonds)			
Assets)				Trade Acceptances Payable	X		
Obsolescence (deduct from				Treasury Stock (deficit)			X
Related Assets)				Unearned Income		X	
Retirement Capital Stock	X			Wages, Unpaid	X		