

# Educational Testing Service

Consolidated Financial Statements as of and for  
the Years Ended September 30, 2020 and 2019,  
Schedule of Expenditures of Federal Awards for  
the Year Ended September 30, 2020, and  
Independent Auditors' Reports in Accordance  
with *Government Auditing Standards* and the  
Uniform Guidance

# EDUCATIONAL TESTING SERVICE

## TABLE OF CONTENTS

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	<b>Page</b>
INDEPENDENT AUDITORS' REPORT	1-2
CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2020 and 2019:	
Statements of Financial Position	3
Statements of Activities	4
Statements of Cash Flows	5-6
Notes to Financial Statements	7-33
SUPPLEMENTAL SCHEDULE FOR THE YEAR ENDED SEPTEMBER 30, 2020:	34
Schedule of Expenditures of Federal Awards	35-40
Notes to Schedule of Expenditures of Federal Awards	41-42
INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	43-44
INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE	45-46
SCHEDULE OF FINDINGS AND QUESTIONED COSTS	47-48
SUMMARY SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS	49



**Deloitte & Touche LLP**  
100 Kimball Drive  
Parsippany, NJ 07054-2176  
USA  
Tel: +1 973 602 6000  
Fax: +1 973 602 5050  
www.deloitte.com

## **INDEPENDENT AUDITORS' REPORT**

The Audit Committee of Educational Testing Service  
660 Rosedale Road  
Princeton, New Jersey 08541

### **Report on the Consolidated Financial Statements**

We have audited the accompanying consolidated financial statements of Educational Testing Service ("ETS") and Subsidiaries (the "Enterprise"), which comprise the consolidated statements of financial position as of September 30, 2020 and 2019, the related consolidated statements of activities, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. The financial statements of the subsidiaries of ETS were not audited in accordance with *Government Auditing Standards*.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Enterprise as of September 30, 2020 and 2019, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

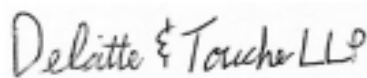
## **Other Matters**

### **Other Information**

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The Schedule of Expenditures of Federal Awards (the "Schedule"), as required by Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of the Enterprise's management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

### **Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2020 on our consideration of the Enterprise's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Enterprise's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Enterprise's internal control over financial reporting and compliance.



December 17, 2020

## EDUCATIONAL TESTING SERVICE

### CONSOLIDATED STATEMENTS OF FINANCIAL POSITION AS OF SEPTEMBER 30, 2020 AND 2019 (Dollars in thousands)

	<u>2020</u>	<u>2019</u>
<b>ASSETS:</b>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 144,042	\$ 168,310
Accounts receivable—less allowance for doubtful accounts of \$1,886 and \$1,444 in 2020 and 2019, respectively	71,603	164,946
Unbilled amounts under contracts	48,328	86,719
Prepaid expenses and other current assets	<u>34,155</u>	<u>33,170</u>
Total current assets	298,128	453,145
INVESTMENTS—At fair value	1,336,644	1,312,880
PROPERTY AND EQUIPMENT—Net	103,256	113,786
CAPITALIZED SOFTWARE—Net	122,808	133,034
GOODWILL—Net	14,707	13,522
IDENTIFIABLE INTANGIBLE ASSETS—Net	2,779	3,490
OTHER LONG-TERM ASSETS	<u>16,401</u>	<u>4,353</u>
TOTAL ASSETS	<u>\$ 1,894,723</u>	<u>\$ 2,034,210</u>
<b>LIABILITIES AND NET ASSETS:</b>		
CURRENT LIABILITIES:		
Accounts payable	\$ 45,265	\$ 60,601
Accrued expenses and other current liabilities	149,989	160,495
Short-term debt	15,911	20,391
Deferred revenue	<u>101,440</u>	<u>119,134</u>
Total current liabilities	312,605	360,621
LONG-TERM DEBT	27,809	41,789
OTHER LONG-TERM LIABILITIES	<u>141,193</u>	<u>140,645</u>
TOTAL LIABILITIES	481,607	543,055
NET ASSETS	<u>1,413,116</u>	<u>1,491,155</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 1,894,723</u>	<u>\$ 2,034,210</u>

*The accompanying notes are an integral part of these consolidated financial statements.*

## EDUCATIONAL TESTING SERVICE

### CONSOLIDATED STATEMENTS OF ACTIVITIES FOR THE YEARS ENDED SEPTEMBER 30, 2020 AND 2019 (Dollars in thousands)

	<u>2020</u>	<u>2019</u>
<b>REVENUES:</b>		
Operating revenues	\$ 1,050,279	\$ 1,358,022
<b>EXPENSES:</b>		
Operating expenses:		
Salaries, wages, and employee benefits	444,793	501,274
Subcontracted services	186,448	258,175
Test administrators, readers, item writers, and other professional services	257,672	328,305
Depreciation and amortization	57,890	67,165
COVID-19 expenses	33,910	-
Other operating and administrative expenses	<u>181,000</u>	<u>270,475</u>
Total operating expenses	<u>1,161,713</u>	<u>1,425,394</u>
OPERATING LOSS	<u>(111,434)</u>	<u>(67,372)</u>
Net realized/unrealized financial gains from investments	31,838	48,394
Interest income/(expense)—Net	367	1,312
Other income/(expense)—Net	<u>(2,064)</u>	<u>(2,753)</u>
DECREASE IN NET ASSETS FROM OPERATIONS, BEFORE INCOME TAX EXPENSE	(81,293)	(20,419)
Income tax expense	<u>(4,157)</u>	<u>(1,687)</u>
DECREASE IN NET ASSETS FROM OPERATIONS	(85,450)	(22,106)
Postretirement benefits	7,051	(9,070)
Foreign currency translation	<u>360</u>	<u>(275)</u>
DECREASE IN NET ASSETS	(78,039)	(31,451)
NET ASSETS—Beginning of year	<u>1,491,155</u>	<u>1,522,606</u>
NET ASSETS—End of year	<u><u>\$ 1,413,116</u></u>	<u><u>\$ 1,491,155</u></u>

*The accompanying notes are an integral part of these consolidated financial statements.*

## EDUCATIONAL TESTING SERVICE

### CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2020 AND 2019 (Dollars in thousands)

	<u>2020</u>	<u>2019</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Decrease in net assets from operations	\$ (85,450)	\$ (22,106)
Adjustments to reconcile decrease in net assets from operations to net cash provided by operating activities:		
Depreciation and amortization	57,890	67,165
Other - goodwill, customer relationships and long-lived assets	2,509	58,160
Net realized financial gains from investments	(12,768)	(4,714)
Net unrealized financial gains from investments	(19,070)	(43,680)
Deferred income taxes	(1,106)	(3,076)
Amortization of debt issuance costs	17	15
Bad debt expense	462	34
Net unrealized foreign exchange transaction loss/(gain)	221	(45)
Changes in operating assets and liabilities:		
Accounts receivable	94,799	(57,272)
Unbilled amounts under contracts	36,367	(1,991)
Prepaid expenses and other assets	(462)	(1,497)
Accounts payable	(12,643)	(1,336)
Accrued expenses and other current liabilities	(10,190)	5,671
Deferred revenue	(18,178)	4,842
Other long-term liabilities	7,577	2,243
Net cash provided by operating activities	39,975	2,413
CASH FLOWS FROM INVESTING ACTIVITIES:		
Consideration paid for acquisitions	(4,150)	-
Proceeds from sales of investments	54,071	3,379
Purchases of property and equipment	(8,648)	(9,330)
Purchases of capitalized software	(29,119)	(29,713)
Purchases of investments	(55,934)	-
Net cash used in investing activities	(43,780)	(35,664)

(Continued)

## EDUCATIONAL TESTING SERVICE

### CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2020 AND 2019 (Dollars in thousands)

	<u>2020</u>	<u>2019</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from debt	\$ 47,950	\$ 4,000
Repayments of debt	(66,346)	(26,149)
Payments of overdraft funds	(1,144)	(1,572)
	<u>(19,540)</u>	<u>(23,721)</u>
Effect of foreign exchange rate changes on cash and cash equivalents	<u>(420)</u>	<u>(504)</u>
DECREASE IN CASH AND CASH EQUIVALENTS AND RESTRICTED CASH	(23,765)	(57,476)
CASH AND CASH EQUIVALENTS AND RESTRICTED CASH—Beginning of year	<u>171,925</u>	<u>229,401</u>
CASH AND CASH EQUIVALENTS AND RESTRICTED CASH—End of year	<u>\$ 148,160</u>	<u>\$ 171,925</u>
SUPPLEMENTARY DISCLOSURES:		
Interest paid	<u>\$ 1,926</u>	<u>\$ 3,179</u>
Income taxes paid	<u>\$ 5,113</u>	<u>\$ 4,820</u>
Capitalized software expenditures included in liabilities	<u>\$ 948</u>	<u>\$ 228</u>
Property and equipment expenditures included in liabilities	<u>\$ 511</u>	<u>\$ 3,190</u>

*The accompanying notes are an integral part of these consolidated financial statements.*

(Concluded)

# EDUCATIONAL TESTING SERVICE

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2020 AND 2019

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### 1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Organization**—Educational Testing Service (“ETS”) is a non-stock corporation exempt from federal income tax under Internal Revenue Code Section 501(c)(3). ETS has wholly-owned for-profit subsidiaries which are not exempt from federal income tax.

**Consolidation**—The consolidated financial statements include the accounts of ETS and its subsidiaries (the “Enterprise”). All intercompany balances and transactions have been eliminated.

**Business**—The Enterprise develops, administers and scores assessments for clients across numerous market segments. In addition to assessments, the Enterprise develops a variety of customized services and products for elementary, secondary (“K-12”) and postsecondary education. The revenue mix includes an array of products and services provided to individuals, educational institutions, foundations and government agencies, as well as a portfolio of proprietary products—including TOEFL<sup>®</sup>, TOEIC<sup>®</sup>, GRE<sup>®</sup>, HiSET<sup>®</sup> and The Praxis Series<sup>®</sup>.

**Basis of Presentation**—The accompanying consolidated financial statements and notes to the consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”).

**Net Assets**—Net assets are not subject to donor-imposed restrictions and may be expended for any purpose in performing the primary objectives of the Enterprise.

**Use of Estimates**—The preparation of consolidated financial statements in accordance with U.S. GAAP requires the Enterprise to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Estimates and assumptions that are significant to the consolidated financial statements include the valuation of investments, goodwill, identifiable intangible assets, postretirement benefits and income taxes. Actual results may differ from those estimates.

**Investments**—Investments are reported at fair value in the consolidated statements of financial position, with associated realized and unrealized gains and losses reported in the consolidated statements of activities. Financial revenues from investments are reported net of related expenses. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Enterprise’s Finance Committee, acting within the authority delegated from the Board of Trustees, oversees investment and valuation policies for investments and has processes in place to ensure that fair value is reasonably estimated. Valuation approaches are reviewed on an ongoing basis. In determining fair value, the Enterprise uses various valuation approaches including the observability of prices and inputs, as well as net asset value (“NAV”) per share. A downturn in market conditions may lead to a decline in the valuation of investments (see Note 3).

**Cash and Cash Equivalents**—Investments that are highly liquid in nature and have an original maturity of three months or less from the date of purchase are considered to be

cash equivalents. Cash and cash equivalents approximate fair value due to the short-term nature of these instruments.

**Restricted Cash**—As of September 30, 2020 and 2019, restricted cash was approximately \$4.1 million and \$3.6 million, respectively, reported in “Other long-term assets” in the consolidated statements of financial position. Restricted cash is generally not available for use in operations.

The following provides a reconciliation of cash and cash equivalents and restricted cash reported within the consolidated statements of financial position to the same amounts reported within the consolidated statements of cash flows.

	<u>2020</u>	<u>2019</u>
Cash and cash equivalents	\$ 144,042	\$ 168,310
Restricted cash reported in other long-term assets	4,118	3,615
Total cash and cash equivalents and restricted cash	<u>\$ 148,160</u>	<u>\$ 171,925</u>

**Accounts Receivable and Allowance for Doubtful Accounts**—Accounts receivable are primarily due from government agencies, professional associations and corporations. Accounts receivable are recorded at invoiced amounts, and generally do not bear interest or require collateral. The Enterprise establishes an allowance for doubtful accounts to reduce accounts receivable to its realizable value based upon factors surrounding the credit risk of specific clients, historical trends, existing economic conditions and other information, which is the Enterprise’s estimate of probable losses.

**Unbilled Amounts Under Contracts**—As of September 30, 2020 and 2019, unbilled revenues in the amount of approximately \$48.3 million and \$86.7 million, respectively, relate primarily to services provided to clients that are billed in arrears.

**Concentrations of Credit Risk**—For the years ended September 30, 2020 and 2019, the Enterprise earned approximately 25.0% and 26.2% of operating revenues, respectively, from one client under a contract that expires on December 31, 2022.

As of September 30, 2020, there were two clients, which represented approximately 31.6% and 22.7% of the accounts receivable outstanding. As of September 30, 2019, there were three clients, which represented approximately 29.0%, 23.4% and 18.0% of the accounts receivable outstanding.

**Property and Equipment**—Property and equipment are stated at cost less accumulated depreciation. Depreciation is computed primarily on a straight-line basis over the following estimated useful lives:

Land improvements	10 years
Buildings and improvements	10–45 years
Leasehold improvements	Lesser of lease term or estimated useful life
Furniture and equipment	3–15 years

**Capitalized Software**—Capitalized software consists of purchased software and internally developed software. Purchased software relates to software products and licenses which are amortized over their estimated useful life which range from three to seven years. Internally developed software costs consist of fees and wages paid to third parties and employees who work on such software development. Capitalized costs are amortized using the straight-line method over the estimated lives which range from three to seven years. Software

development projects generally include three stages: the preliminary project stage (all costs are expensed as incurred), the application development stage (certain costs are capitalized as permissible while others are expensed as incurred), and the post-implementation/operation stage (all costs are expensed as incurred).

**Business Combinations**—The Enterprise accounts for business combinations using the acquisition method. Under the acquisition method, identifiable net assets are recorded at fair value at the acquisition date. The sum of the consideration transferred less the fair value of net assets acquired is recorded to goodwill. The transaction costs of acquiring a business typically include legal, accounting and other advisory fees, as well as the costs to integrate acquired business processes all of which are expensed as incurred.

**Goodwill**—The Enterprise follows the impairment provisions and disclosure requirements in accordance with the accounting guidance related to goodwill and other intangibles. The Enterprise accounts for goodwill by amortizing it on a straight-line basis over a period of 10 years. If a triggering event were to occur, the Enterprise tests goodwill for impairment. When testing for goodwill impairment, the Enterprise, at its option, may perform a qualitative or quantitative assessment. If qualitative factors indicate that the fair value of goodwill is greater than its carrying amount, additional impairment testing is not required. In performing its quantitative assessment, the Enterprise compares the fair value of the respective reporting unit with its carrying amount. If the carrying amount of a reporting unit exceeds its fair value, an impairment loss would be recognized in an amount equal to the excess (see Note 7).

**Identifiable Intangible Assets**—The Enterprise's indefinite-lived intangible assets are tested for impairment annually, as of July 1st of each year, or more frequently if circumstances warrant. The Enterprise, at its option, may perform a qualitative or quantitative assessment. If qualitative factors indicate that the fair value of an indefinite-lived intangible asset is greater than its carrying amount, additional impairment testing is not required. In performing its quantitative assessment, the Enterprise compares the estimated fair value of an indefinite-lived intangible asset with its carrying value. If the carrying value exceeds its fair value an impairment loss would be recognized in an amount equal to the excess. Intangible assets that have finite useful lives are amortized over their useful lives using the straight-line method (see Note 7).

**Impairment of Long-Lived Assets**—The carrying values of long-lived assets other than indefinite-lived intangible assets and goodwill are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Such evaluation relies on a number of factors, including operating results, future anticipated cash flows, and other nonfinancial data. Recoverability of long-lived assets other than indefinite-lived intangible assets and goodwill is assessed based on comparing the asset group's carrying amount to the estimated undiscounted future net cash flows. If the estimated undiscounted future net cash flows are less than the carrying amount, the asset group is tested further for impairment. If necessary, the carrying amount of the asset group is reduced to its fair value based on discounted future net cash flows.

**Self-Insurance**—Certain insurable risks such as health and welfare benefits and workers compensation are self-insured by the Enterprise. However, the Enterprise's claims exposure is mitigated, subject to specified limits, due to stop-loss insurance coverage. The Enterprise analyzes its claims experience and other information provided by its administrators to determine an adequate liability for self-insured claims for both reported, and incurred but not yet reported claims. As of September 30, 2020 and 2019, self-insurance obligations of approximately \$5.4 million and \$6.2 million, respectively, are reported in "Accrued expenses" in the consolidated statements of financial position.

**Postretirement Benefits**—The accumulated postretirement benefit obligation represents the actuarial present value of benefits attributed to employee services already rendered. The

measurement of the benefit obligation and net periodic benefit cost includes certain assumptions including estimates of discount rates, expected return on plan assets, healthcare assumptions and mortality rates.

**Deferred Revenue**—The Enterprise receives candidate payments in advance of test administrations and fees from clients under contract in advance of service obligations. The Enterprise records these payments as deferred revenue prior to revenue being recognized. As of September 30, 2020 and 2019, the Enterprise has collected all amounts, other than \$7.4 million and \$11.4 million, respectively, related to the timing of client billing.

**Recognition of Revenue**—The Enterprise recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, fees are fixed or determinable, and collectability is probable. The Enterprise evaluates the underlying delivery of products and/or services which give rise to the payment of consideration under its arrangements to determine the appropriate revenue recognition.

*Multiple Element Arrangements*—The Enterprise accounts for multiple element arrangements by assigning arrangement consideration at the inception of an arrangement to all elements based on their relative selling price. The relative selling price method allows a vendor to use its best estimate of selling price (“ESP”) if neither vendor specific objective evidence nor third party evidence of selling price exists. The Enterprise will determine an element’s ESP if sold on a standalone basis via actual contract prices or based on internal pricing analysis. When determining ESP, the Enterprise will consider market conditions such as competitor pricing strategies, customer demands, geographical regions and industry practices. Items within an arrangement are considered as separate units of accounting, either individually or in the aggregate, as disclosed below.

The Enterprise’s multiple element arrangements primarily require the delivery of test development services, test administration, and test delivery, scoring and reporting services. Arrangements typically include elements that have value to the client in combination with other services, and therefore do not have standalone value and continue to be accounted for as a single unit of accounting. Other arrangements may include elements that have standalone value to the client, but the consideration received under the arrangements is subject to satisfaction of contingent obligations, and therefore, revenue is not permitted to be recognized prior to the delivery of the contingent services.

Revenue for multiple element arrangements that represent a single unit of accounting is recognized generally over the term of the arrangement, or the expected period of performance on a straight-line, proportional performance, or completion of performance basis. In general, the Enterprise has determined cost as an appropriate input measure to recognize revenue on a proportional performance basis.

*Test Development Services*—Test development services include psychometric analysis, test design and construction, item development, job analysis and test publishing or any combination of such services. In general, the Enterprise recognizes revenue for test development services as part of a single unit of accounting in a multiple element arrangement as disclosed above.

*Test Administration*—Revenue is recognized for Enterprise-owned test assessments when the tests are scored, unless recognized as a single unit of accounting in a multiple element arrangement as disclosed above.

*Test Delivery, Scoring and Reporting Services*—Test delivery arrangements include system management, registration, scheduling, administration and results processing or any combination of such services. The Enterprise recognizes revenue for test delivery, scoring

and reporting services as part of a single unit of accounting in a multiple element arrangement as disclosed above.

*Ancillary Assessment Services and Products*—Revenue for test preparation products is recognized when the products are shipped, transfer of title and risk of loss has passed to the customer and all other revenue recognition criteria are satisfied. For ancillary assessment services, revenue is recognized upon performance of those services.

*Software and Other Services*—The Enterprise primarily delivers or hosts software via licensing arrangements, which typically do not have significant service commitments following the delivery of the software. The license fee is earned upon delivery of the software and the remaining service commitments, if any, are recognized ratably over the contract term. Revenue for each element is based on the relative selling price method. Fees for hosting arrangements where the customer does not take possession of the Enterprise's software or run the software on client-owned hardware are recognized ratably over the term of the agreement.

**Recognition of Expense**—Items are Enterprise test assessment questions and related content. Item development costs consist of payments to third party item writers and wages to employee item writers. The Enterprise expenses item development costs as incurred.

The Enterprise defers expenses incurred for test administration and recognizes the expenses when the related revenue is recognized. The Enterprise also defers client contract transition expenditures, which relate to the set-up of processes, personnel and systems, and expenses them ratably over the period that the respective services are provided. As of September 30, 2020 and 2019, deferred expenses of approximately \$9.1 million and \$9.8 million, respectively, which relate to expenses incurred for test administration are reported in "Prepaid expenses and other current assets" in the consolidated statements of financial position.

**Measure of Operations**—The consolidated statements of activities report all changes in net assets, including changes in net assets from operating activities. Operating activities consist of those items attributable to revenue from the Enterprise's program services, research programs and other activities. Net realized and unrealized financial gains from investments, interest income/(expense)—net, other income/(expense)—net, income tax expense, change in postretirement benefits and foreign currency translation are excluded from operating income/(loss).

**Functional Expenses**—The costs of providing program services and other supported activities have been summarized by natural classification in the consolidated statements of activities. In addition, costs have been allocated among program services and support services (see Note 12).

**Advertising Costs**—For the years ended September 30, 2020 and 2019, advertising costs of approximately \$9.7 million and \$11.3 million, respectively, were expensed as incurred and reported in "Test administrators, readers, item writers and other professional services" in the consolidated statements of activities.

**Income Taxes**—The Enterprise does not record a provision for federal or state income taxes with respect to income generated from not-for-profit activities because of its tax-exemption. An income tax provision is recorded for non-exempt foreign activities as well as for the for-profit activities of Enterprise subsidiaries.

Deferred tax assets and liabilities are recognized for the expected future consequences of differences between the financial statement and income tax basis assets and liabilities.

Deferred tax assets and liabilities are determined based on the temporary differences between the financial and tax reporting of particular assets, liabilities and loss carryforwards using tax rates for the years in which the differences are expected to reverse. The effect of a change in tax law and rates on deferred tax assets and liabilities is recognized as a change in net assets in the period that includes the enactment date. A valuation allowance is recorded to offset deferred tax assets if, based on the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

The calculation of tax liabilities includes estimates for uncertainties in tax positions. The impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant tax authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained based on technical merits. The Enterprise records liabilities for uncertain tax benefits net of deferred tax assets associated with tax loss carryforwards, for liabilities arising in the same and in different years from the asset, provided the related tax loss can be carried back or forward to offset the liability.

Income tax expense is the aggregate of tax that is payable for the current period and the change in deferred tax assets and liabilities. The Enterprise classifies interest, penalties, and foreign exchange related to income tax liabilities as income tax expense.

**Foreign Currency Translation/Transactions**—For all operations outside the United States of America (“U.S.”) in which the local currency has been designated as the functional currency, assets and liabilities are translated into U.S. dollars using year-end exchange rates, and revenue and expenses are translated using average exchange rates for the year. Foreign currency translation adjustments are accumulated as changes in “Net assets”. As of September 30, 2020 and 2019, net accumulated foreign currency translation losses of approximately \$27,000 and \$387,000, respectively, are reported in “Net assets” in the consolidated statements of financial position.

Transactions denominated in currencies other than the functional currency are recorded based on exchange rates at the time such transactions arise. Subsequent changes in exchange rates result in transaction gains or losses which are recorded upon settlement of the transactions. For the years ended September 30, 2020 and 2019, net transaction losses of approximately \$1.1 million and \$99,000, respectively, are reported in “Other operating and administrative expenses” in the consolidated statements of activities. Transaction gains and losses related to income taxes are reported in “Income tax (expense)/benefit” in the consolidated statements of activities.

**Contingencies**—The Enterprise may be subject to loss contingencies such as legal proceedings and various claims in the normal course of business. The Enterprise accrues for such loss contingencies, including related legal fees, when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. The Enterprise discloses loss contingencies when there is a reasonable possibility that a loss may have occurred.

**Recently Adopted Accounting Pronouncements**—In November 2016, the Financial Accounting Standards Board (“FASB”) issued authoritative accounting guidance which clarifies the presentation of restricted cash on the statement of cash flows. Entities are required to include restricted cash within cash and cash equivalents on the statement of cash flows and disclose any required reconciliation to the statement of financial position, if applicable. The guidance was adopted on October 1, 2019 and was applied retrospectively, resulting in an increase of approximately \$3.5 million in “Cash and cash equivalents and restricted cash—beginning of year” in the consolidated statement of cash flows as of October 1, 2018.

In March 2017, the FASB issued authoritative accounting guidance which amends and improves the presentation of net periodic postretirement benefit cost. The guidance requires entities to disaggregate the current service cost component from the net benefit cost and present it with other compensation costs for related employees on the statement of activities. Entities are also required to present the remaining components of net periodic postretirement benefit cost elsewhere on the statement of activities as components of other comprehensive income. The guidance was adopted on October 1, 2019 and was applied retrospectively. There was no impact on "Net assets—beginning of year" as of October 1, 2018. For the year ended September 30, 2019, the Enterprise reported approximately \$3.7 million of service cost in "Salaries, wages, and employee benefits" and approximately \$2.8 million of other components of net periodic benefit cost in "Other income and expense" in the consolidated statement of activities.

**Recently Issued Accounting Pronouncements**—In May 2014, the FASB issued authoritative accounting guidance for recognizing revenue from contracts with customers, which supersedes the existing revenue recognition standard. The guidance introduces a single, comprehensive, five-step revenue recognition model, and enhances disclosures related to revenue recognition. In June 2020, the FASB issued accounting guidance permitting private entities that have not issued their financial statements to defer the adoption of the guidance by one year, and the Enterprise elected to defer. The guidance is effective October 1, 2020, and allows for either a full retrospective or modified retrospective approach at adoption. The Enterprise is evaluating the impact of this guidance on its consolidated financial statements.

In February 2016, the FASB issued authoritative accounting guidance for leases, which supersedes the existing standard. The new guidance increases transparency and comparability among entities by recognizing lease assets and liabilities on the statement of financial position and disclosing key information about leasing arrangements. For leases with a term of twelve months or less, a lessee is permitted to elect an accounting policy by class of underlying asset, not to recognize lease assets and liabilities. In June 2020, the FASB issued accounting guidance permitting private entities to defer the adoption of the guidance by one year. The guidance is effective October 1, 2022. The Enterprise is evaluating the impact of this guidance on its consolidated financial statements.

In June 2016, the FASB issued authoritative accounting guidance for current expected credit losses. Under this guidance the Enterprise will recognize as an allowance, an estimate of expected credit losses, if any. The guidance permits early adoption and is effective October 1, 2022. The Enterprise is evaluating the impact of this guidance on its consolidated financial statements.

In August 2018, the FASB issued authoritative accounting guidance which amends defined postretirement benefit plan disclosures. The following disclosures are no longer required: (1) the amounts in accumulated other comprehensive income expected to be recognized into net periodic benefit cost over the next fiscal year, (2) the rollforward for Level 3 fair value measurements, and (3) the effects of a one-percentage change in assumed healthcare cost trend rate on net the periodic benefit cost and the benefit obligation. The following disclosures have been added: (1) the weighted-average crediting interest rate for plans with promised crediting interest rates and (2) an explanation for the reasons for significant gains/(losses) related to the change in the benefit obligation. The guidance permits early adoption, is effective October 1, 2021, and may be applied either retrospectively or prospectively. The Enterprise is evaluating the impact of this guidance on its disclosures in the consolidated financial statements.

In August 2018, the FASB issued authoritative accounting guidance which amends fair value disclosures. The following disclosures are no longer required: (1) the policy, amounts and

reasons for transfers between Level 1 and Level 2 fair value measurements, (2) the valuation processes for Level 3 fair value measurements, and (3) the reporting of changes in unrealized gains/(losses) for the period for recurring fair value measurements held at the end of the reporting period. The following disclosures have been modified: (1) in lieu of a rollforward for Level 3 fair value measurements, disclosure of purchases and transfers into/out of Level 3 shall be made, (2) for investments reported at NAV, entities shall disclose the timing of liquidation of an investee's assets and the date when restrictions from redemption may lapse, and (3) information regarding any uncertainty in measurements as of the reporting date shall be disclosed as applicable. The guidance permits early adoption, is effective October 1, 2021, and may be applied either retrospectively or prospectively. The Enterprise is evaluating the impact of this guidance on its disclosures in the consolidated financial statements.

In December 2019, the FASB issued authoritative accounting guidance which simplify the accounting for income taxes by removing certain exceptions to the general principles. The guidance also improves consistent application and simplifies generally accepted accounting principles for other areas of accounting for income taxes by clarifying and amending existing guidance. The guidance permits early adoption, is effective October 1, 2022, and may be applied prospectively. The Enterprise is evaluating the impact of this guidance on its consolidated financial statements

## 2. LIQUIDITY AND THE AVAILABILITY OF RESOURCES

The Enterprise has resources available to meet the cash needs for expenditures within one year of the date of the consolidated statement of financial position. These resources include cash and cash equivalents of approximately \$144.0 million. In addition, the Enterprise has additional resources through the collection of accounts receivable of approximately \$71.6 million and unbilled amounts under contracts of approximately \$48.3 million. The Enterprise also has long-term investments of approximately \$1.3 billion should there be a need to meet cash requirements for any unanticipated expenditures.

## 3. INVESTMENTS AND FAIR VALUE MEASUREMENTS

As of September 30, 2020 and 2019, investments were as follows (dollars in thousands):

Asset Category	2020		2019	
	Fair Market Value	Cost	Fair Market Value	Cost
Money market funds (*)	\$ 134,659	\$ 134,659	\$ 156,656	\$ 156,656
Investments:				
Mutual funds	155,399	145,789	207,123	195,039
Commingled funds (**)	945,073	914,643	892,415	871,526
Alternative investments	<u>236,172</u>	<u>218,108</u>	<u>213,342</u>	<u>207,281</u>
Subtotal investments	<u>1,336,644</u>	<u>1,278,540</u>	<u>1,312,880</u>	<u>1,273,846</u>
Total assets	<u>\$ 1,471,303</u>	<u>\$ 1,413,199</u>	<u>\$ 1,469,536</u>	<u>\$ 1,430,502</u>

(\*) Money market funds are classified in "Cash and cash equivalents" in the consolidated statements of financial position.

(\*\*) As of September 30, 2020, commingled funds include net securities sold of approximately \$1.5 million that were settled after September 30, 2020.

For the years ended September 30, 2020 and 2019, the Enterprise reported net financial gains from investments of approximately \$31.8 million and \$48.4 million, net of related expenses of approximately \$4.5 million and \$4.8 million, respectively, in "Net realized/unrealized financial gains from investments" in the consolidated statements of activities.

The accounting framework for fair value provides a hierarchy that prioritizes the inputs for valuation techniques. The hierarchy gives the highest priority to Level 1 measurements and the lowest priority to Level 3 measurements. The most observable inputs are used when available. The three levels of the fair value hierarchy are described as follows:

*Level 1*—Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Enterprise has the ability to access.

*Level 2*—Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and inputs that are derived from or corroborated by observable market data by correlation or other means.

*Level 3*—Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs. The Enterprise invests with professional managers in separately managed accounts, or in professionally managed funds among diversified asset classes with a variety of investment managers. The categorization of an investment within the fair value hierarchy is based on the pricing transparency of the investment and does not necessarily correspond to the Enterprise's perceived risk of the investment.

The following is a description of the valuation methodologies and inputs used for assets measured at fair value. There were no significant changes in the methodologies used at September 30, 2020 and 2019.

*Mutual Funds*—Mutual funds are investments in registered investment companies that are valued at quoted market prices at the close of the Enterprise's last business day of the year and are classified within Level 1.

*Money Market Funds*—Money market funds are managed to maintain a constant value, though not guaranteed, of \$1 and are classified within Level 1.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While the Enterprise believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments may result in different fair value measurements at the reporting date.

The Enterprise's policy is to report investment transfers in and out, or between the levels at the end of the reporting period. During the years ended September 30, 2020 and 2019, there were no transfers of investments between the Levels.

The Enterprise also follows the accounting guidance for measuring fair value using NAV as a practical expedient for commingled funds and alternative investment funds. The practical expedient allows for measurement, without adjustment, for certain investments that do not have a readily determinable fair value, and that prepare financial statements consistent with the principals of an investment company. The NAVs are reported by the investment managers, which may use third-party pricing sources, and are determined principally from the fair value of the underlying fund holdings.

*Commingled Funds at NAV*—Commingled funds consist of funds of traded securities from several accounts blended together and multi-strategy fund-of-funds, organized by trust agreements under state registration.

*Alternative Investment Funds at NAV*—Alternative investment funds consist of investments in hedge funds and private equity funds. The estimated valuation of certain investments of the underlying funds, which may include private placements, and other securities for which prices are not readily available, are determined by the management of the respective underlying funds and may not reflect amounts that could be realized upon immediate sale, nor amounts that ultimately may not be realized.

These funds invest in directional market strategies (primarily long/short-term equity) as well as non-directional strategies (such as event driven and relative value).

As of September 30, 2020 and 2019, assets measured at fair value were as follows (dollars in thousands):

<b>Asset Category</b>	<b>2020</b>			<b>Total</b>
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	
Money market funds <sup>(a)</sup>	\$ 134,659	\$ -	\$ -	\$ 134,659
Investments:				
Mutual funds	155,399	-	-	155,399
Commingled funds at NAV <sup>(b)</sup>				945,073
Alternative investment funds at NAV <sup>(b)</sup>				<u>236,172</u>
Subtotal investments				<u>1,336,644</u>
Total assets				<u>\$ 1,471,303</u>

Asset Category	2019			
	Level 1	Level 2	Level 3	Total
Money market funds <sup>(a)</sup>	\$ 156,656	\$ -	\$ -	\$ 156,656
Investments:				
Mutual funds	207,123	-	-	207,123
Commingled funds at NAV <sup>(b)</sup>				892,415
Alternative investment funds at NAV <sup>(b)</sup>				<u>213,342</u>
Subtotal investments				<u>1,312,880</u>
Total assets				<u>\$ 1,469,536</u>

(a) Money market funds are classified in "Cash and cash equivalents" in the consolidated statements of financial position.

(b) In accordance with the accounting guidance for fair value measurements, investments measured at NAV have not been classified in the fair value hierarchy. The amounts presented in this table are intended to permit a reconciliation to the amounts presented in the consolidated statements of financial position.

As of September 30, 2020, commingled funds include net securities sold of approximately \$1.5 million that were settled after September 30, 2020.

As of September 30, 2020 and 2019, additional information relative to the Enterprise's investments reported at NAV was as follows (dollars in thousands):

Asset Category	Fair Value		Redemption Notice Period	Other Restrictions
	2020	2019		
Commingled funds <sup>(a)</sup>	\$ 945,073	\$ 892,415	1-110 days	See below
Alternative investments funds <sup>(b)</sup>	<u>236,172</u>	<u>213,342</u>	See below	See below
Total	<u>\$ 1,181,245</u>	<u>\$ 1,105,757</u>		

(a) All commingled funds, except for the real estate equity fund, require notice of 1 to 3 business days and may be redeemed when settled within 1 to 2 days. The real estate equity fund requires notice of 110 calendar days and may be redeemed 20 calendar days after the quarter end. Redemption requests for the real estate equity fund will be allocated on a pro-rata basis based on available liquidity.

(b) Alternative investments in hedge funds, depending on the fund, generally require notice ranging from 31 to 90 calendar days and may be redeemed within 15 to 90 calendar days. Most hedge funds include hold-backs ranging from 5 to 10% that are released after the fund's annual financial statement audit.

In closed-end limited partnership and private equity funds, the funds cannot be redeemed voluntarily. The fund will initiate distributions as soon as practicable following the dissolution of the underlying investment vehicles.

As of September 30, 2020 and 2019, there were approximately \$116.2 million and \$94.5 million, respectively, in unfunded commitments to alternative investments in private equity funds.

#### 4. PROPERTY AND EQUIPMENT

As of September 30, 2020 and 2019, property and equipment—net was as follows (dollars in thousands):

	<u>2020</u>	<u>2019</u>
Buildings and leasehold improvements	\$ 220,407	\$ 217,308
Furniture and equipment	89,417	92,202
Land and land improvements	<u>11,708</u>	<u>11,714</u>
Total	321,532	321,224
Less accumulated depreciation	<u>(218,276)</u>	<u>(207,438)</u>
Net	<u>\$ 103,256</u>	<u>\$ 113,786</u>

For the years ended September 30, 2020 and 2019, depreciation expense was approximately \$15.5 million and \$17.6 million, respectively, reported in "Depreciation and amortization" in the consolidated statements of activities.

For the year ended September 30, 2020, the Enterprise determined that certain assets were no longer recoverable and an impairment charge of approximately \$965,000 was recorded and reported in "Other operating and administrative expenses" in the consolidated statement of activities. For the year ended September 30, 2019, the Enterprise determined that no events or circumstances occurred that impacted long-lived property and equipment.

#### 5. CAPITALIZED SOFTWARE

As of September 30, 2020 and 2019, capitalized software—net was as follows (dollars in thousands):

	<u>2020</u>	<u>2019</u>
Capitalized software:		
Internally developed	\$ 594,138	\$ 569,294
Purchased	<u>22,052</u>	<u>23,457</u>
Total	616,190	592,751
Less accumulated amortization	<u>(493,382)</u>	<u>(459,717)</u>
Net	<u>\$ 122,808</u>	<u>\$ 133,034</u>

For the years ended September 30, 2020 and 2019, amortization expense was approximately \$39.7 million and \$42.4 million, respectively, reported in "Depreciation and amortization" in the consolidated statements of activities.

For the year ended September 30, 2020, the Enterprise determined that certain capitalized software assets were no longer recoverable and an impairment of approximately \$1.4 million was recorded and reported in "Other operating and administrative expenses" in the consolidated statement of activities. For the year ended September 30, 2019, the Enterprise determined that no events or changes in circumstances occurred that impacted long-lived capitalized software asset values.

## 6. ACQUISITIONS AND DIVESTURES

On June 24, 2020, the Enterprise acquired 100% of the capital stock of a language skills assessment company. The acquisition is a strategic fit with the Enterprise to improve capabilities for English language assessments. The fair value of the consideration transferred was approximately \$3.0 million and was recorded to "Goodwill—net" in the consolidated statement of financial position. Contingent consideration in the form of earnout payments are payable for three years ending September 30, 2021, 2022 and 2023. The earnout payments are based on achieving certain benchmarks of operating revenue and net income.

On September 15, 2020 the Enterprise acquired select assets of an internet-driven software platform. The acquisition is a strategic fit with the Enterprise's graduate admissions testing. The fair value of the consideration transferred was approximately \$1.2 million, of which approximately \$900,000 was recorded to "Capitalized software—net" and approximately \$300,000 of client relationships was recorded to "Identifiable intangible assets—net" in the consolidated statement of financial position.

## 7. IDENTIFIABLE INTANGIBLE ASSETS AND GOODWILL

As of September 30, 2020 and 2019, identifiable intangible assets—net were as follows (dollars in thousands):

	<b>2020</b>			<b>Net Carrying Amount</b>
	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Other</b>	
Client relationships	\$ 9,205	\$ (6,996)	\$ -	\$ 2,209
Tradenames and trademarks	570	-	-	570
Total	<u>\$ 9,775</u>	<u>\$ (6,996)</u>	<u>\$ -</u>	<u>\$ 2,779</u>
	<b>2019</b>			
	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Other</b>	<b>Net Carrying Amount</b>
Client relationships	\$ 13,937	\$ (5,985)	\$ (5,032)	\$ 2,920
Tradenames and trademarks	13,470	-	(12,900)	570
Total	<u>\$ 27,407</u>	<u>\$ (5,985)</u>	<u>\$ (17,932)</u>	<u>\$ 3,490</u>

Finite lived intangible assets are amortized over their estimated useful lives as follows:

	<b>Range of Useful Lives in Years</b>
Client relationships	7 to 9

For the years ended September 30, 2020 and 2019, amortization expense was approximately \$1.0 million and \$2.0 million, respectively, reported in "Depreciation and amortization" in the consolidated statements of activities.

As of September 30, 2020, the estimated amortization expense for the next five years was as follows (dollars in thousands):

<b>For the Year Ending September 30,</b>	<b>Estimated Amortization Expense</b>
2021	\$ 512
2022	400
2023	332
2024	332
2025	332
Thereafter	-

For the year ended September 30, 2020, there was no impairment of the client relationships intangible asset. Changes in certain significant client contracts for the year ended September 30, 2019 resulted in a review of the recoverability of the client relationships intangible asset during the year. An impairment of approximately \$5.0 million was recorded and reported in "Other operating and administrative expenses" in the consolidated statement of activities for the year ended September 30, 2019.

The impairment tests of the Enterprise's indefinite-lived tradenames and trademarks involved a comparison of estimated fair values with their carrying values. During 2020, the Enterprise completed its impairment tests for indefinite-lived tradenames and trademarks and determined that there was no impairment for the year ended September 30, 2020. During 2019, the Enterprise completed its impairment test and determined that certain of the assets were impaired. As a result of a reduction in future cash flows an impairment of approximately \$12.9 million was recorded and reported in "Other operating and administrative expenses" in the consolidated statement of activities for the year ended September 30, 2019.

In valuing its tradenames and trademarks, the Enterprise utilized a quantitative income approach, specifically, the relief-from-royalty-method. In estimating the fair values, the Enterprise calculated the present value of future earnings associated with the royalty savings related to the trademarks, using a weighted average cost of capital. The projections and calculations used in the Enterprise's impairment models include Level 3 fair value inputs and reflect its assumptions regarding revenue growth rates, market trends, business mix, cost structure and other assumptions about the anticipated short-term and long-term operating results.

The changes in the carrying value of goodwill are as follows (dollars in thousands):

	<u>2020</u>	<u>2019</u>
Balance—October 1,	\$ 13,522	\$ 58,515
Additions	2,950	-
Amortization	(1,588)	(4,765)
Impairment	<u>(177)</u>	<u>(40,228)</u>
Balance—September 30,	<u>\$ 14,707</u>	<u>\$ 13,522</u>

For the years ended September 30, 2020 and 2019, amortization expense for goodwill was approximately \$1.6 million and \$4.8 million, respectively, reported in "Depreciation and amortization" in the consolidated statements of activities. As a result of changes in client contracts, the Enterprise performed a goodwill impairment test for one of its reporting units and determined that it was impaired for the years ended September 30, 2020 and 2019. Changes in the competitive marketplace led to adjusted revenue expectations. As a result, the Enterprise expects a reduction in future cash flows that have decreased the fair value of the reporting unit and goodwill by approximately \$177,000, and \$40.2 million reported in "Other operating and administrative expenses" in the consolidated statement of activities for the years ended September 30, 2020 and 2019.

The Enterprise performed a quantitative assessment for goodwill impairment testing for a reporting unit. In performing the impairment testing, the Enterprise estimated the fair value of its reporting unit based on a weighting of two models, a discounted cash flow model and a market multiple model, both of which included Level 3 fair value inputs. The discounted cash flow model used the reporting unit's business plans and projections as the basis for expected operating performance, future cash flows, and discounts the cash flows using a weighted average cost of capital based on the target capital structure of the industry. The market multiple approach utilizes market multiples of revenues or earnings for companies comparable to the Enterprise's reporting units. The Enterprise believes the assumptions used for the impairment test are consistent with those that would only be utilized by a market participant performing similar valuations for the reporting unit.

## 8. DEBT

As of September 30, 2020 and 2019, debt was comprised as follows (dollars in thousands):

	<b>2020</b>				
	<b>Amount Available</b>	<b>Maturity</b>	<b>Carrying Amount</b>	<b>Rate</b>	<b>Estimated Fair Value</b>
Term loan (*)	\$ 47,950	2023	\$ 43,720	1.75%	\$ 43,720
Line of credit secured	50,000	2023	-	-	-
Total			43,720		<u>\$ 43,720</u>
Less short-term			(15,911)		
Long-term portion of debt			<u>\$ 27,809</u>		
	<b>2019</b>				
	<b>Amount Available</b>	<b>Maturity</b>	<b>Carrying Amount</b>	<b>Rate</b>	<b>Estimated Fair Value</b>
Term loan (*)	\$ 85,000	2022	\$ 62,180	3.00%	\$ 60,117
Line of credit, unsecured	50,000	2020	-	-	-
Total			62,180		<u>\$ 60,117</u>
Less short-term			(20,391)		
Long-term portion of debt			<u>\$ 41,789</u>		

(\*) Carrying value is reported net of amortizing debt issuance costs.

**Term Loan**—On August 14, 2020, the Enterprise entered into a \$48.0 million term loan, which was used to repay its previous term loan. The term loan is secured by the Enterprise's investments and is guaranteed by a subsidiary of the Enterprise. Interest accrues at the daily three-month London InterBank Offered Rate ("LIBOR") plus 150 basis points, and is payable quarterly. Scheduled principal payments are due each quarter through the maturity date, at which time all remaining principal becomes due. The fair value of debt is based on an indicative valuation that includes Level 3 inputs, such as projected interest and discount rates. The previous \$85.0 million term loan accrued interest at the daily LIBOR plus 87 basis points and was payable quarterly. Scheduled principal payments were due quarterly through the repayment date.

**Line of Credit**—The Enterprise has a \$50.0 million line of credit, which bears interest at a rate of one-month LIBOR plus 150 basis points, and expires August 14, 2023. The line of credit is secured by the Enterprise's investments and is guaranteed by a subsidiary of the Enterprise. The Enterprise may request, in lieu of cash advances, standby letters of credit not to exceed \$5.0 million. There were no borrowings or outstanding balances under the secured line of credit during the years ended September 30, 2020 and 2019. The line of credit is subject to earlier termination in the event of default, whereas outstanding balances, if any, are due on demand.

As of September 30, 2020, the aggregate minimum maturities of debt were as follows (dollars in thousands):

<b>Years Ending September 30,</b>	<b>Term Loan</b>
2021	\$ 15,983
2022	15,983
2023	11,988
2024	-
2025	-
Thereafter	-
Total minimum payments	<u><u>\$ 43,954</u></u>

**Covenants**—The Enterprise’s debt facilities contain various financial and non-financial covenants. The Enterprise believes it was in compliance with all covenants as of September 30, 2020 and 2019.

## 9. INCOME TAXES

The Enterprise has provided for income taxes based upon the tax laws and rates in effect within the jurisdictions where the Enterprise’s activities are conducted. For the years ended September 30, 2020 and 2019, the decrease in net assets from continuing operations, before income tax, by jurisdiction were as follows (dollars in thousands):

	<b>2020</b>	<b>2019</b>
United States	\$ (73,135)	\$ (21,261)
Other jurisdictions	(8,158)	842
Total	<u><u>\$ (81,293)</u></u>	<u><u>\$ (20,419)</u></u>

For the years ended September 30, 2020 and 2019, the components of income tax expense/(benefit) from continuing operations were as follows (dollars in thousands):

	<b>2020</b>	<b>2019</b>
United States:		
Current	\$ 81	\$ 169
Deferred	(22)	(3,106)
Total United States	<u>59</u>	<u>(2,937)</u>
Other jurisdictions:		
Current	5,222	4,598
Deferred	(1,124)	31
Total other jurisdictions	<u>4,098</u>	<u>4,629</u>
Total	<u><u>\$ 4,157</u></u>	<u><u>\$ 1,692</u></u>

For the years ended September 30, 2020 and 2019, the Enterprise's effective tax rate was (5.1)% and (8.3)%, respectively, and differed from the statutory U.S. federal income tax rate primarily due to its tax exempt status in the U.S., permanent items, foreign taxes and a change to the valuation allowance.

The historical cumulative earnings of foreign subsidiaries are expected to be reinvested indefinitely, and therefore, U.S. deferred tax liabilities are not provided on these amounts. As of September 30, 2020 and 2019, cumulative foreign earnings related to ongoing operations were approximately \$163,000 and \$131,000, respectively.

Deferred income taxes result from temporary differences between the amount of assets and liabilities recognized for financial and tax reporting purposes. As of September 30, 2020 and 2019, the components of the net deferred tax asset and net deferred tax liability, were as follows (dollars in thousands):

	<u>2020</u>	<u>2019</u>
Accounts receivable	\$ 241	\$ 124
Accrued expenses	1,722	1,486
Deferred revenue	25	18
Credit carryforwards	40	80
Net capital losses	2,762	2,762
Net operating losses	<u>40,047</u>	<u>32,526</u>
Total deferred tax asset	44,837	36,996
Valuation allowance	<u>(40,200)</u>	<u>(32,216)</u>
Net deferred tax asset	<u>4,637</u>	<u>4,780</u>
Goodwill and other long-lived assets	<u>(2,991)</u>	<u>(4,240)</u>
Total deferred tax liability	<u>(2,991)</u>	<u>(4,240)</u>
Net deferred tax asset/(liability)	<u>\$ 1,646</u>	<u>\$ 540</u>

As of both September 30, 2020 and 2019, the Enterprise reported foreign capital loss carryforwards in the amount of approximately \$12.0 million, which have an indefinite carryforward period. As of September 30, 2020 and 2019, the Enterprise reported federal, state and foreign operating loss carryforwards in the amount of approximately \$227.1 million and \$179.7 million, respectively, of which, approximately \$46.0 million and \$23.6 million, respectively, have an indefinite carryforward period and approximately \$181.1 million and \$156.1 million, respectively, expires in future years between 2021 and 2040.

As of September 30, 2020 and 2019, the valuation allowance for deferred tax assets of approximately \$40.2 million and \$32.2 million, respectively, relates to the uncertainty of the utilization of certain deferred tax assets, primarily net operating and capital losses. The Enterprise has evaluated positive and negative evidence regarding the realization of these assets and has concluded that they are not likely to be realized.

As of September 30, 2020, the Enterprise had a net income tax receivable of approximately \$176,000, reported in "Prepaid expenses and other current assets" in the consolidated statement of financial position. As of September 30, 2019, the Enterprise had a net income tax payable of approximately \$209,000, reported in "Accrued expenses" in the consolidated statement of financial position.

As of September 30, 2020 and 2019, the total gross amount of income tax reserves, reported in "Other long-term liabilities" in the consolidated statements of financial position, was approximately \$11.7 million and \$11.0 million, respectively. Accrued interest and penalties as of September 30, 2020 and 2019 were approximately \$4.1 million and \$3.8 million, of which an approximate \$379,000 and \$7,000 of expense was recognized for the years ended September 30, 2020 and 2019, respectively. As of September 30, 2020 and 2019, long-term deferred tax liabilities, reported in "Other long-term liabilities" in the consolidated statements of financial position, were approximately \$3.0 million and \$4.5 million, respectively.

An unrecognized tax benefit is the aggregate tax effect of differences between tax return positions and the benefits recognized in the consolidated financial statements. It is reasonably possible that the Enterprise's balance of gross unrecognized tax benefits may change within the next twelve months due to the lapse of applicable statutes of limitation in various jurisdictions, or if the Enterprise becomes subject to examination. The Enterprise assessed that it has made adequate provision for income tax uncertainties, including accrued interest and penalties, if applicable. Although in the U.S., the Enterprise is not currently under examination by the Internal Revenue Service ("IRS"), it remains possible that the Enterprise's liability for unrecognized tax benefits could change over that time period. A subsidiary was audited by the IRS for the tax year ended October 31, 2017. The audit was closed without any adjustment on October 9, 2020. Additionally, the statute of limitations for tax years 2016 through 2018 remain open for three years from the date of filing. For state income tax purposes, the statute of limitations includes tax years from 2015 through 2018 with statutes ranging from three to four years. For international jurisdictions, open statutes primarily range from three to ten years.

## 10. LEASE COMMITMENTS

Future minimum rental payments under operating and capitalized leases, inclusive of escalation clauses, relate principally to certain office space and other equipment that have initial or remaining non-cancelable lease terms in excess of one year. As of September 30, 2020, future lease commitments were as follows (dollars in thousands):

<b>Years Ending September 30,</b>	<b>Operating</b>	<b>Capital</b>
2021	\$ 6,694	\$ 85
2022	5,777	79
2023	4,914	52
2024	4,066	16
2025	4,112	-
Thereafter	<u>6,493</u>	<u>-</u>
Total minimum payments	<u>\$ 32,056</u>	232
Less interest		<u>(19)</u>
Total capitalized lease obligation		213
Less short-term portion of capitalized lease obligation		<u>(74)</u>
Long-term portion of capitalized lease obligation		<u>\$ 139</u>

As of September 30, 2020 and 2019, the short and long-term capitalized lease obligations were reported in "Accrued expenses" and "Other long-term liabilities", respectively, in the consolidated statements of financial position.

For the years ended September 30, 2020 and 2019, rent expense was approximately \$13.8 million and \$14.8 million, respectively, and is reported in "Other operating and administrative expenses" in the consolidated statements of activities.

For the year ended September 30, 2020, the Enterprise recorded for certain leases, an impairment of approximately \$8.0 million in "Other operating and administrative expenses" in the consolidated statement of activities.

## 11. COMMITMENTS

As of September 30, 2020, the Enterprise's future purchase commitments under contractual obligations were as follows (dollars in thousands):

<b>Years Ending September 30,</b>	<b>Computer Systems <sup>(a)</sup></b>	<b>Software and Hosted Services <sup>(b)</sup></b>
2021	\$ 21,859	\$ 16,619
2022	21,177	15,460
2023	15,752	3,511
2024	-	879
2025	-	-
Thereafter	-	-
Total minimum payments	<u>\$ 58,788</u>	<u>\$ 36,469</u>

(a) In March 2018, the Enterprise renewed its outsourced computer systems services by entering into an agreement that will expire on June 30, 2023. The agreement includes early termination provisions that require 6-month pre-notification at any time and the reimbursement of certain expenses. For the years ended September 30, 2020 and 2019, expense related to this agreement was approximately \$33.2 million and \$44.8 million, respectively, and is reported in "Test administrators, readers, item writers, and other professional services" in the consolidated statements of activities.

(b) In December 2008, the Enterprise entered into an agreement to outsource the software testing, operation and maintenance of a portfolio of its information technology applications that was extended, and will expire on June 30, 2023. The agreement includes various partial and inclusive termination provisions. For the years ended September 30, 2020 and 2019, the expense related to this agreement was approximately \$22.4 million and \$24.4 million, respectively, and is reported in "Test administrators, readers, item writers, and other professional services" in the consolidated statements of activities.

In June 2020, the Enterprise renewed its agreement to outsource managed hosting service of certain financial applications that will expire December 31, 2023. The agreement includes early termination provisions that require 6-month pre-notification and payments based on a prescribed scale. For the years ended September 30, 2020 and 2019, the expense related to this agreement was approximately \$3.9 million and \$4.0 million, respectively, and is reported in "Test administrators, readers, item writers, and other professional services" in the consolidated statements of activities.

In October 2017, the Enterprise entered into an agreement to outsource managed hosting and certain call center support services that will expire October 1, 2021. The agreement includes early termination provisions that require payments based on a prescribed scale of remaining monthly charges. For the years ended September 30, 2020 and 2019, the expense related to this agreement was approximately \$1.5 million and \$934,000, respectively, and is reported in "Test administrators, readers, item writers, and other professional services" in the consolidated statements of activities.

In September 2018, the Enterprise entered into an agreement to outsource managed cloud and managed security services, that will expire on January 31, 2023. The agreement includes early termination provisions that require payments based on a prescribed scale. For the years ended September 30, 2020 and 2019, the expense related to this agreement was approximately \$13.5 million and \$4.2 million, respectively, and is reported in "Test administrators, readers, item writers, and other professional services" in the consolidated statements of activities.

In August 2009, the Enterprise entered into a Power Purchase Agreement ("PPA") to receive installation, maintenance, and operation of solar energy efficient photovoltaic systems on certain of its owned facilities that will expire on August 10, 2029. The Enterprise shall purchase 100% of the energy delivered by the systems at negotiated rates. The PPA contains early termination and system purchase provisions. For the years ended September 30, 2020 and 2019, the expense related to this agreement was approximately \$217,000 and \$201,000, respectively, and is reported in "Other operating and administrative expenses" in the consolidated statements of activities.

In January 2018, the Enterprise entered into a master services agreement for primarily computer-based test delivery services through January 29, 2028. The agreement may be automatically extended and contains early termination provisions. The Enterprise shall purchase 100% of the volume-based services. For the years ended September 30, 2020 and 2019, the expense related to this agreement was approximately \$41.7 million and \$63.8 million, respectively, and is reported in "Subcontracted services" in the consolidated statements of activities.

The above agreements have certain variable components such as billings based on usage, performance standards, incentives for managing costs, and improvements in demand capabilities. Future obligations for such variable components may vary, and therefore have been excluded from the above commitments.

Liabilities for uncertain tax positions were excluded from the future purchase commitments under contractual obligations table as the Enterprise is not able to determine in which period payment would be required.

## 12. EXPENSES BY FUNCTIONAL CLASSIFICATION

For the year ended September 30, 2020, operating expenses by functional classification were as follows (dollars in thousands):

	2020		
	Program Services	Support Services	Total
Salaries, wages and employee benefits	\$ 231,186	\$ 213,607	\$ 444,793
Subcontracted services	159,671	26,777	186,448
Test administrators, readers, item writers and other professional services	184,366	73,306	257,672
Depreciation and amortization	27,491	30,399	57,890
COVID-19 expenses	-	33,910	33,910
Other operating and administrative expenses	90,092	90,908	181,000
Total	<u>\$ 692,806</u>	<u>\$ 468,907</u>	<u>\$ 1,161,713</u>

	2019		
	Program Services	Support Services	Total
Salaries, wages and employee benefits	\$ 251,357	\$ 249,917	\$ 501,274
Subcontracted services	238,834	19,341	258,175
Test administrators, readers, item writers and other professional services	237,532	90,773	328,305
Depreciation and amortization	31,675	35,490	67,165
Other operating and administrative expenses	171,283	99,192	270,475
Total	<u>\$ 930,681</u>	<u>\$ 494,713</u>	<u>\$ 1,425,394</u>

## 13. PERFORMANCE BONDS

The Enterprise provides performance bonds relating to matters arising in the ordinary course of business. As of September 30, 2020, the Enterprise has deposited approximately \$3.5 million as collateral for certain of its performance bonds.

## 14. LITIGATION

The Enterprise is involved in various litigation matters arising in the ordinary course of business. The Enterprise is of the opinion that the liability, if any, resulting from pending legal actions and claims would not have a material effect on the consolidated financial statements.

## 15. WARRANTIES AND INDEMNIFICATIONS

Under the Enterprise's standard contractual terms and conditions with its clients, the Enterprise provides certain warranties and indemnifications in relation thereto. The Enterprise is not aware of any instances that would result in material payments being made as a result of these warranties and indemnifications.

## 16. POSTRETIREMENT BENEFITS

**Retirement Plans**—The Enterprise sponsors several defined contribution retirement plans offering retirement benefits that allow eligible employees to contribute a portion of their compensation through payroll deductions in accordance with specified plan guidelines. The Enterprise makes contributions to those plans that include a matching percentage of the employees' contributions up to certain limits. In addition, the Enterprise offers an employer contribution plan to eligible employees that vests over a two-year period, as well as supplemental contributory deferred compensation plans. For the years ended September 30, 2020 and 2019, the Enterprise's expense related to its defined contribution retirement plans approximated \$27.2 million and \$28.8 million, respectively, and is reported in "Salaries, wages, and employee benefits" in the consolidated statements of activities.

**Retiree Medical and Life Insurance Benefit Plan**—The Enterprise provides postretirement medical and prescription drug and limited life insurance benefits for retired employees and their dependents ("participants") if they fulfill the eligibility requirements of the Retiree Medical and Life Insurance Benefit Plan (the "Plan"). Effective January 1, 2018, retiree life insurance coverage was no longer provided for participants not meeting the age and service eligibility requirements for coverage prior to January 1, 2018. Life insurance coverage for all retired participants already covered under the Plan was settled through a guaranteed life insurance funding account, which is a liability transfer solution, of approximately \$3.2 million for the year ended September 30, 2018. All active employees meeting the age and service eligibility requirement as of December 31, 2017 are eligible for life insurance within the Plan's prescribed timeframe.

During August 2018, the Plan's investments in the ETS Retiree Medical Benefits Plan Trust were depleted through benefits payments, and it was terminated in accordance with the trust agreement. After August 2018, claims are paid directly by ETS.

The Plan's Employer Group Waiver Plan ("EGWP") subsidy design includes direct federal subsidies and coverage gap discounts. The EGWP subsidy is equivalent to the allowable percentage of costs that the Enterprise funds for prescription drug benefits to eligible Medicare beneficiaries. Participants who were hired or rehired after June 30, 2012 pay 100% of the actuarial-equivalent cost of postretirement medical coverage. Plan contributions are reviewed and changes if any, are implemented annually.

For the years ended September 30, 2020 and 2019, the Enterprise's net periodic benefit costs were as follows (dollars in thousands):

<b>Components of Net Periodic Benefit Cost</b>	<b>2020</b>	<b>2019</b>
Service cost	\$ 4,082	\$ 3,709
Interest cost	3,563	4,325
Amortization of:		
Prior service credit	(1,499)	(1,572)
Net periodic benefit cost	<u>\$ 6,146</u>	<u>\$ 6,462</u>

As of September 30, 2020 and 2019, the service cost component of net periodic benefit cost of approximately \$4.1 million and \$3.7 million, respectively, is reported in "Salaries, wages, and employee benefits" in the consolidated statements of activities. As of September 30, 2020 and 2019, all other components of net periodic benefit cost of approximately \$2.1 million and \$2.8 million, respectively, are reported in "Other income/(expense)" in the consolidated statements of activities.

The accounting for postretirement benefit obligations requires the use of actuarial assumptions to reflect the uncertainties and the length of time over which the postretirement benefit obligations will be paid. The actual amount of future benefit payments depends on when participants retire, the amount of their benefit at retirement, and their lifespan. To reflect the obligation in current dollars, future payments are discounted to present value, using a rate that aligns with the time frame over which payments will be made.

As of September 30, 2020 and 2019, assumptions used in valuing the postretirement benefit obligation were as follows:

	<b>2020</b>	
Discount rate	3.11 %	
Service cost discount rate	3.32 %	
Interest cost discount rate	2.50 %	
Mortality table	PRI-2012 with white collar adjustment using MP-2019	
Health care cost trend:	<u>Pre-65:</u>	<u>Post-65:</u>
Select rate	6.49 %	6.80 %
Ultimate rate	4.50 %	4.50 %
Year until ultimate rate is reached	2029	2029
	<b>2019</b>	
Discount rate	3.52 %	
Service cost discount rate	3.66 %	
Interest cost discount rate	3.14 %	
Mortality table	RP-2014 with white collar adjustment using MP-2018	
Health care cost trend:	<u>Pre-65:</u>	<u>Post-65:</u>
Select rate	6.80 %	7.30 %
Ultimate rate	4.50 %	4.50 %
Year until ultimate rate is reached	2025	2025

The assumptions used to measure the postretirement benefit obligation at the end of the year are used to measure the net periodic benefit cost in the following year. For the years ended September 30, 2020 and 2019, assumptions used in valuing the net periodic benefit cost were as follows:

	<b>2020</b>	
Discount rate	3.51 %	
Service cost discount rate	3.67 %	
Interest cost discount rate	3.14 %	
Mortality table	RP-2014 with white collar adjustment using MP-2018	
Health care cost trend:	<u>Pre-65:</u>	<u>Post-65:</u>
Select rate	6.80 %	7.30 %
Ultimate rate	4.50 %	4.50 %
Year until ultimate rate is reached	2025	2025
	<b>2019</b>	
Discount rate	4.38 %	
Service cost discount rate	4.43 %	
Interest cost discount rate	4.19 %	
Mortality table	RP-2014 with white collar adjustment using MP-2017	
Health care cost trend:	<u>Pre-65:</u>	<u>Post-65:</u>
Select rate	7.30 %	7.90 %
Ultimate rate	4.50 %	4.50 %
Year until ultimate rate is reached	2024	2024

As of September 30, 2020 and 2019, a reconciliation of the Enterprise's benefit obligation was as follows (dollars in thousands):

<b>Change in Benefit Obligation</b>	<b>2020</b>	<b>2019</b>
Benefit obligation—October 1,	\$ 121,397	\$ 109,338
Service cost	4,082	3,709
Interest cost	3,563	4,325
Actuarial (gain)/loss	(8,550)	7,497
Plan participants' contributions	1,953	1,648
Actual benefits paid	(5,601)	(4,983)
Retiree life insurance transfer	(545)	(137)
Benefit obligation—September 30,	<u>\$ 116,299</u>	<u>\$ 121,397</u>

As of September 30, 2020 and 2019, the unfunded status of the benefit obligation is approximately \$116.3 million and \$121.4 million, respectively. It is expected that postretirement benefit obligations will be funded by the Enterprise and its participants.

The current portion of the unfunded status of the benefit obligation is reported within "Accrued expenses", and the long-term portion of the unfunded status of the benefit

obligation is reported within "Other long-term liabilities" in the consolidated statements of financial position.

As of September 30, 2020 and 2019, amounts included in "Net assets" in the consolidated statements of financial position that are expected to be amortized to net periodic benefit cost in future years are as follows (dollars in thousands):

	<u>2020</u>	<u>2019</u>
Net actuarial loss	\$ 3,156	\$11,707
Prior service credit	<u>(5,100)</u>	<u>(6,599)</u>
Total	<u><u>\$ (1,944)</u></u>	<u><u>\$ 5,108</u></u>

For the year ending September 30, 2021, the Enterprise estimates that approximately \$1.5 million of prior service credit from "Net assets" will be recognized into net periodic benefit cost.

The following benefit payments, which reflect expected future service, as appropriate, were expected to be paid as follows (dollars in thousands):

**Years Ending September 30,**

2021	3,664
2022	3,686
2023	3,731
2024	3,811
2025	3,911
2026 to 2030	21,465

**17. SIGNIFICANT EVENT**

The World Health Organization declared coronavirus ("COVID-19") a "Public Health Emergency of International Concern" on January 30, 2020 and a global pandemic on March 11, 2020. COVID-19 has severely impacted the global economies and the pandemic was disruptive to the Enterprise's business for the year ended September 30, 2020 as a result of the temporary closures and restrictions mandated by various governmental authorities intended to combat the pandemic. As a result, testing activities decreased significantly for the year ended September 30, 2020. To mitigate the negative impact of the COVID-19 pandemic, the Enterprise deployed various staffing actions that resulted in approximately \$33.9 million in severance and unemployment expenses reported in "COVID-19 expenses" in the statement of activities for the year ended September 30, 2020. The Enterprise continues to closely monitor the impact of COVID-19 on its business including how it is impacting its customers, vendors and business partners.

On March 27, 2020, the U.S. Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") was enacted in response to COVID-19. The CARES Act includes various financial measures to assist entities, including temporary changes to income and non-income-based tax laws. The CARES Act did not have a material effect on the consolidated financial statements.

## **18. SUBSEQUENT EVENTS**

The Enterprise has evaluated all material events or transactions that occurred after September 30, 2020 through December 17, 2020, the date the consolidated financial statements were available to be issued and has determined there were no subsequent events requiring adjustment to or disclosure in the consolidated financial statements.

\* \* \* \* \*

**SUPPLEMENTAL SCHEDULE**

**EDUCATIONAL TESTING SERVICE**  
**Employer Identification #21-0634479**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2020**

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<u>Federal Agency Program Title</u>	<u>Federal CFDA #</u>	<u>Grant/Award Period</u>	<u>Grant/Award Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Passthrough to Subrecipients</u>	<u>Total Federal Expenditures</u>
<b>Research &amp; Development Cluster:</b>						
<b>U.S. Department of Education</b>						
<b>Direct:</b>						
USED/IES - National Assessment of Educational Progress ("NAEP") 2019-2024 - Planning and Coordination Contract	84.R&D	July 19 - June 24	91990019C0043	-	\$ -	\$ 3,502,944
USED/IES - National Assessment of Educational Progress ("NAEP") 2019-2024 - Design, Analysis and Reporting Contract	84.R&D	July 19 - June 24	91990019C0045	-	-	16,387,481
USED/IES - National Assessment of Educational Progress ("NAEP") 2019-2024 - Item Development Contract	84.R&D	July 19 - June 24	91990019C0046	-	-	10,349,862
USED/IES - National Assessment of Educational Progress ("NAEP") 2019-2024 - Platform Development Contract	84.R&D	July 19 - June 24	91990019C0051	-	-	15,883,639
USED/IES - What Types of Knowledge Matters for What Type of Comprehension? Exploring the Role of Background Knowledge on Students' Ability to Learn from Multiple Texts	84.305A	September 15 - August 20	R305A150176	-	-	97,102
USED/IES - Exploring Writing Achievement and Its Role in Success at 4-Year Postsecondary Institutions	84.305A	July 16 - June 21	R305A160115	-	-	300,539
USED/IES-Learning Progression-Based and NGSS-Aligned Formative Assessment for Using Mathematical Thinking in Science	84.305A	July 16 - June 20	R305A160219	-	-	193,469

**EDUCATIONAL TESTING SERVICE**  
**Employer Identification #21-0634479**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2020**

<u>Federal Agency Program Title</u>	<u>Federal CFDA #</u>	<u>Grant/Award Period</u>	<u>Grant/Award Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Passthrough to Subrecipients</u>	<u>Total Federal Expenditures</u>
<b>Research &amp; Development Cluster (Continued):</b>						
<b>U.S. Department of Education</b>						
<b>Direct:</b>						
USED/IES - Developing and Validating Web-Administered, Reading for Understanding Assessments for Adult Education	84.305A	September 16 - October 19	R305A160129	-	\$ 17,641	\$ 23,784
USED/IES - Research Training Programs in the Education Sciences	84.305B	May 17 - March 20	R305B160020	-	-	100,181
USED/IES - A Theory and Data Driven Approach for Identifying Evidence of Collaborative Problem Solving Skills	84.305A	July 17 - June 20	R305A170432	-	139,782	378,063
USED/IES - Development of Statistically Sound Methods and User-friendly Software for Performing Data Forensics	84.305D	July 17 - June 20	R305D170026	-	-	49,007
USED/IES - Changing Together: Classroom Observation for Peer Feedback and Reflection (C2)	84.305A	July 18 - June 22	R305A180149	-	-	177,504
USED/IES - Improving Students' Mathematics Experiences: How does success impact students' memories, motivation and engagement?	84.305A	July 19 - June 21	R305A190024	-	61,896	276,527
USED/IES - Exploring and Assessing the Development of Students' Argumentation Skills	84.305A	August 19 - July 21	R305A190242	-	151,419	261,144

**EDUCATIONAL TESTING SERVICE**

**Employer Identification #21-0634479**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)**

**FOR THE YEAR ENDED SEPTEMBER 30, 2020**

<u>Federal Agency Program Title</u>	<u>Federal CFDA #</u>	<u>Grant/Award Period</u>	<u>Grant/Award Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Passthrough to Subrecipients</u>	<u>Total Federal Expenditures</u>
<b>Research &amp; Development Cluster (Continued):</b>						
<b>U.S. Department of Education</b>						
<b>Sub Awards:</b>						
Pass through: Westat - PIAAC National Supplement (COST)	84.R&D	November 12 - September 22	s6056-01	ED-IES-12-C-0072	\$ -	\$ 13,613
Pass through: Boston University - Validating an Observation Protocol for the Evaluation of Special Educators	84.324A	July 15 - June 20	4500001896	R324A150231	-	108,509
Pass through: Northern Illinois University - Testing onPAR Model in Developmental Literacy Education	84.305A	July 15 - June 20	G1A62574	R305A150193	-	7,527
Pass through: The Trustees of Indiana University - Education Research, DAT-CROSS: Developing Assessments & Tools to Support the Teaching & Learning of Science Crosscutting Concepts	84.305A	October 17 - September 20	IN4240214ETS	R305A170634	-	140,131
Pass through: RTI International - High School and Beyond Assessments	84.R&D	May 18 - May 23	1-312-0216458-65283L	GS-00Q-14-OADU-217	-	523,626
Pass through: USED/IES - WestEd - Reading Apprenticeship SEED 2018	84.423A	October 18 - September 20	S-00017017	U423A180020	-	18,244
<b>National Science Foundation</b>						
<b>Direct:</b>						
NSF - Developing Preservice Elementary Teachers' Ability to Facilitate Goal-Oriented Discussion in Science and Math	47.076	August 16 - July 21	1621344	-	103,033	726,530

**EDUCATIONAL TESTING SERVICE****Employer Identification #21-0634479****SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)****FOR THE YEAR ENDED SEPTEMBER 30, 2020**

<u>Federal Agency Program Title</u>	<u>Federal CFDA #</u>	<u>Grant/Award Period</u>	<u>Grant/Award Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Passthrough to Subrecipients</u>	<u>Total Federal Expenditures</u>
<b>Research &amp; Development Cluster (Continued):</b>						
<b>National Science Foundation</b>						
<b>Direct:</b>						
NSF - Development and Empirical Recovery for a Learning Progression-Based Assessment of the Function Concept	47.076	September 16 - August 21	1621117	-	\$ 357,215	\$ 481,414
NSF - Big Data Collaborative Research IA Latent and Graphic Models for Complex Dependent Data in Education	47.070	January 17 - December 20	1633353	-	-	60,309
NSF - Developing & Validating Assessments to Measure & Build Elementary Teachers' Content Knowledge for Teaching about Matters & Its Interactions within Teacher Education Setting	47.076	July 18 - June 22	NSF1813254	-	-	312,385
NSF - Collaborative Research: Supporting Teachers in Responsive Instruction for Developing Expertise in Science	47.076	September 18 - August 22	1812660	-	-	103,015
NSF - RAPID: Learning to Teach During COVID-19: Leveraging Simulated Classrooms as Practice-Based Spaces for Preservice Elementary Teachers within Online Teacher Education Courses	47.076	June 15-May 21	2032179	-	-	76,669
NSF - Student Reasoning Patterns in Next Generation Science Standards Assessment	47.076	July 20-June 22	2000492	-	-	16,719
NSF - Online Practice Suite: Practice Spaces, Simulations and Virtual Reality Environments for Preservice Teachers to Learn to Facilitate Argumentation Discussions in Math and Science	47.076	August 20-July 23	2037983	-	-	17,308

**EDUCATIONAL TESTING SERVICE**  
**Employer Identification #21-0634479**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2020**

<u>Federal Agency Program Title</u>	<u>Federal CFDA #</u>	<u>Grant/Award Period</u>	<u>Grant/Award Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Passthrough to Subrecipients</u>	<u>Total Federal Expenditures</u>
<b>Research &amp; Development Cluster (Continued):</b>						
<b>National Science Foundation</b>						
<b>Sub Awards:</b>						
Pass through: Regents of University of California - Project Learning with Automated Networked Supports (PLANS)	47.070	May 15 - April 20	00008787	1451604	\$ -	\$ 3,126
Pass through: UTSA - Educational Research Training Program P-20 Pipeline Issues	84.305B	September 16 - August 20	1000003254	R305B160008	-	8,882
<b>Department of Defense</b>						
<b>Direct:</b>						
Army Research Institute - Refinement and Validation of the Cross Cultural Competency Assessment System Battery	12.431	July 16 - April 21	W911NF-16-2-0011	-	415,208	591,304
Army Research Institute - Scoring Situational Judgment Tests: The Effect of Subject Matter Expert Qualifications	12.630	February 18 - November 20	W911NF-18-2-0018	-	-	10,313
Army Research Institute (ARI) Collaborative Problem Solving (CPS) Skills: Estimating an Individual's Contribution to Small Group Performance	12.431	June 19 - June 22	W911NF-19-1-0106	-	-	278,896
<b>Department of Health and Human Services</b>						
<b>Sub Awards:</b>						
Pass through: RAND Corporation - Improving Causal Inference Tools for Addiction Researchers	93.279	October 18 - June 21	9920180102	R01DA045049	-	81,076
Pass through: Mathematica Policy Research, Inc. - Head Start Family and Child Experiences Survey (FACES) 2019	84.R&D	October 19 - January 21	50515S05664	HHSP2332015 000351/HHSP 23337024T	-	37,897

**EDUCATIONAL TESTING SERVICE**  
**Employer Identification #21-0634479**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Concluded)**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2020**

<u>Federal Agency Program title</u>	<u>Federal CFDA #</u>	<u>Grant/Award Period</u>	<u>Grant/Award Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Passthrough to Subrecipients</u>	<u>Total Federal Expenditures</u>
<b>U.S. Department of State</b>						
<b>Direct:</b>						
USDOS - Let's Get Serious: Comic Videos Promoting Study in the US	19.040	September 18-June20	SIN65018GR0054	-	\$ -	\$ 75,000
<b>TOTAL RESEARCH AND DEVELOPMENT CLUSTER</b>					<u>1,246,194</u>	<u>51,673,739</u>
<b>OTHER PROGRAMS:</b>						
<b>U.S. Department of Education</b>						
<b>Direct:</b>						
USED - Regional Comprehensive Center at ETS - Florida & Islands	84.283B	October 12 - December 19	S283B120037	-	-	315,938
USED - Regional Comprehensive Center Program - Region 3	84.283B	October 19 - October 24	S283B190024	-	-	848,615
<b>TOTAL OTHER PROGRAMS</b>					<u>-</u>	<u>1,164,553</u>
<b>TOTAL FEDERAL EXPENDITURES</b>					<u>\$ 1,246,194</u>	<u>\$ 52,838,292</u>

See notes to Schedule of Expenditures of Federal Awards

**EDUCATIONAL TESTING SERVICE  
EMPLOYER IDENTIFICATION #21-0634479**

**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
AS OF AND FOR THE YEAR ENDED SEPTEMBER 30, 2020**

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**1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Educational Testing Service ("ETS") is a non-stock corporation exempt from federal income tax under Internal Revenue Code Section 501(c)(3). ETS has wholly owned for-profit subsidiaries which are not exempt from federal income tax. The consolidated financial statements include the accounts of ETS and its subsidiaries (the "Enterprise"). All intercompany balances and transactions have been eliminated. The audits, in accordance with *Government Auditing Standards*, did not include the operations of the subsidiaries of ETS because those entities did not receive federal awards subject to audit in accordance with *Title 2 U.S. Code of Federal Regulations ("CFR") Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the "Uniform Guidance"), but those entities were subject to audit in accordance with auditing standards generally accepted in the United States of America. The accompanying consolidated financial statements and notes to the consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America.

The accompanying Schedule of Expenditures of Federal Awards (the "Schedule") includes the federal award activity of ETS. The information in this Schedule is presented in accordance with the requirements of the Uniform Guidance. The Schedule's expenditures are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain expenditures are not allowable or are limited for reimbursement.

Further, because the Schedule presents only the federal awards of ETS, it is not intended to, and does not, present the financial position, revenues, expenses, and changes in net assets of the Enterprise.

For purposes of the Schedule, federal awards include all grants, contracts, and similar agreements entered into directly between ETS and agencies or departments of the federal government and all sub awards to ETS by nonfederal organizations pursuant to federal grants, contracts, and similar agreements.

**2. INDIRECT COST RATES**

ETS utilizes indirect cost rates approved by the cognizant agency, in lieu of the 10.0% de minimis indirect cost rate allowed under the Uniform Guidance.

**3. CATALOG OF FEDERAL DOMESTIC ASSISTANCE ("CFDA") IDENTIFYING NUMBERS**

The programs' titles and CFDA numbers were obtained from the federal or pass-through grantor, or from [cfda.gov](http://cfda.gov) or [grants.gov](http://grants.gov). When no CFDA number had been assigned to a program, the two-digit federal agency identifier, a period, and the federal contract or grant number was used. If the programs in the Schedule do not have a contract or grant number, the number shown as the CFDA number could be the awarding agency's two-digit prefix (or 99, if the awarding agency is not specified within the catalog) followed by "R&D", for the Research & Development Cluster.

#### **4. RELATIONSHIP TO FEDERAL AND PASS THROUGH ENTITY FINANCIAL REPORTS**

The regulations and guidelines governing the preparation of Federal and Pass through entities' financial reports vary by Pass through entity and Federal agency, and among programs administered by the same agency. Accordingly, the amounts reported in the Federal and Pass through entities' financial reports do not necessarily agree with the amounts reported in the accompanying Schedule of Expenditures of Federal Awards, which is prepared as explained in Note 1 above.



**Deloitte & Touche LLP**  
100 Kimball Drive  
Parsippany, NJ 07054-2176  
USA  
Tel: +1 973 602 6000  
Fax: +1 973 602 5050  
www.deloitte.com

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER  
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

The Audit Committee of Educational Testing Service  
660 Rosedale Road  
Princeton, New Jersey 08541

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Educational Testing Service ("ETS") and Subsidiaries (the "Enterprise"), which comprise the consolidated statements of financial position as of September 30, 2020, the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated December 17, 2020. The financial statements of the subsidiaries of ETS were not audited in accordance with *Government Auditing Standards* and accordingly this report does not include reporting on internal control over financial reporting or instances of reportable noncompliance associated with the subsidiaries of ETS.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the consolidated financial statements, we considered the Enterprise's internal control over financial reporting ("internal control") as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Enterprise's internal control. Accordingly, we do not express an opinion on the effectiveness of the Enterprise's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's consolidated financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

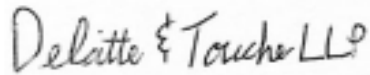
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Enterprise's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the consolidated financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

## **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Enterprise's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in blue ink that reads "Deloitte & Touche LLP". The signature is written in a cursive, professional style.

December 17, 2020



**Deloitte & Touche LLP**  
100 Kimball Drive  
Parsippany, NJ 07054-2176  
USA  
Tel: +1 973 602 6000  
Fax: +1 973 602 5050  
www.deloitte.com

## **INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE**

The Audit Committee of Educational Testing Service  
660 Rosedale Road  
Princeton, New Jersey 08541

### **Report on Compliance for Each Major Federal Program**

We have audited Educational Testing Service ("ETS") and Subsidiaries (the "Enterprise") compliance with the types of compliance requirements described in the *OMB Circular Compliance Supplement* that could have a direct and material effect on each of the Enterprise's major federal programs for the year ended September 30, 2020. The Enterprise's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs.

Our audit, described below, did not include the operations of the subsidiaries of ETS because those entities did not receive federal awards subject to audit in accordance with *Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* ("Uniform Guidance").

### **Management's Responsibility**

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

### **Auditors' Responsibility**

Our responsibility is to express an opinion on compliance for each of the Enterprise's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Uniform Guidance. Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Enterprise's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Enterprise's compliance.

### **Opinion on Each Major Federal Program**

In our opinion, the Enterprise complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2020.

### **Report on Internal Control Over Compliance**

Management of the Enterprise is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Enterprise's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Enterprise's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

*Deloitte & Touche LLP*

December 17, 2020

**EDUCATIONAL TESTING SERVICE  
EMPLOYER IDENTIFICATION #21-0634479**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED SEPTEMBER 30, 2020**

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**SECTION I—SUMMARY OF AUDITORS' RESULTS**

FINANCIAL STATEMENTS

Type of auditors' report issued: Unmodified

Internal control over financial reporting:

Material weakness(es) identified?  Yes  No

Significant deficiency(ies) identified?  Yes  None reported

Noncompliance material to financial statements noted?  Yes  No

FEDERAL AWARDS

Internal control over major programs:

Material weakness(es) identified?  Yes  No

Significant deficiency(ies) identified?  Yes  None reported

Type of auditors' report issued on compliance for major programs: Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?  Yes  No

**Identification of major programs**

**CFDA Number(s):**

Various CFDA

**Name of Program or Cluster:**

Research and Development Cluster

Dollar threshold used to distinguish between Type A and Type B programs: \$1,585,149

Auditee qualified as low-risk auditee?  Yes  No

(Continued)

**EDUCATIONAL TESTING SERVICE  
EMPLOYER IDENTIFICATION #21-0634479**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED SEPTEMBER 30, 2020**

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**SECTION II—FINANCIAL STATEMENT FINDINGS AND RESPONSES:**

No matters were reported.

**SECTION III—FEDERAL AWARD FINDINGS AND QUESTIONED COSTS:**

No matters were reported.

(Concluded)



**EDUCATIONAL TESTING SERVICE  
EMPLOYER IDENTIFICATION #21-0634479**

**SUMMARY SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED SEPTEMBER 30, 2020**

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Not applicable – There were no findings reported in the prior year.