Financial Stability

What Can Regulators Do When the Numbers Don’t Add Up?

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Financial Stability

- Introductions
- Overview of Presentation
  - Why Should Regulators Be Concerned with the Financial Stability of Private Schools?
  - How Can Regulators Evaluate the Financial Stability of Private Schools?
    - Do You Have the Right Information?
    - What Does the Information Tell You?

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- How Can a Regulator Respond to a Concern about Financial Instability?
  - What Questions Should You Ask?
  - What Information Might You Want to See?
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- Financial Stability of Private Schools - Why Does It Matter?
  - State Concerns – Consumer Protection / Academic Quality
    - Does School Have Necessary Resources to Continue Operating and to Deliver on Its Promises to Students?
    - If School Fails, What Is Impact on State Tuition Recovery Fund?
    - Does School Have Sufficient Resources to Deliver a Quality Academic Product?

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- Accrediting Agency Concerns – Academic Quality / Student Interests
  - Does School Have Sufficient Resources to Deliver a Quality Academic Product?
  - Does School Have Necessary Resources to Deliver on Its Promises to Students?

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- U.S. Department of Education Concerns – Federal Resources
  - Does School Have Sufficient Resources to Continue Operating so that Students Can Finish Their Programs?
  - Does School Have Sufficient Resources to Manage Federal Funds Properly?
  - Does School Have Necessary Resources to Make Appropriate R2T4 Payments and Refunds Timely?
## Types of Financial Statements

- **Statements with No Accountant’s Report – Prepared Internally**
  - Compilation (or Compiled Financial Statements)
    - Prepared by Accountant
    - Accountant Simply Assembles Financial Information in Proper Format
    - No Testing of Information by Accountant, and No Opinion by Accountant of Accuracy of Report

- **Review**
  - Prepared by Accountant
  - Accountant May Do Some Testing of Information and May Provide Negative Assurance that There Is No Reason Was Found to Question Accuracy of Report

- **Audit**
  - Prepared by Accountant / Auditor
  - Auditor Will Test Company’s Internal Controls, Transactions, and Account Balances

- **Auditor Will Provide an Opinion**
  - If Unqualified, Will State that Statements Present Fairly in All Material Respects the Financial Position, Results of Operation, and Cash Flows of Company
  - If Qualified, Will Outline Exceptions or Concerns
How to Determine Whether a School Is Financially Stable?

- **Traditional Measures**
  - Review Income Statement – Is School Profitable?
  - Review Balance Sheet
    - Current Ratio – Does School Have Sufficient Resources to Pay Its Current Debts?

- Acid Test Ratio – Does School Have Sufficient Cash and Cash Equivalents to Pay Its Current Debts?
- Equity (Net Worth) – Does School Have More Assets than Liabilities? In Other Words, Is the School Worth Anything?

- Review Cash Flow Statement – Is the School Generating More Cash than It Is Consuming?
- Review Auditor’s Opinion and Notes to Audit
  - Does the Auditor’s Opinion Describe Any Issues or Concerns?
  - Does the Auditor Question the School’s Ability to Continue as a “Going Concern”? 
  - Do the Notes Disclose Any Open or Pending Issues or Events that Could Have a Material Impact on the School?
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- U.S. Department of Education’s Financial Responsibility Standards
  - Composite Score – Sum of Three Separate and Weighted Ratios
    - Ratios
      - Primary Reserve Ratio – A Measure of School’s Viability and Liquidity
      - Adjusted Equity as a Percentage of Total Expenses

Counts as 30% of Composite Score

- Equity Ratio – A Measure of School’s Capital Resources and Ability to Borrow
- Modified Equity as a Percentage of Modified Expenses
- Counts as 40% of Composite Score
- Net Income Ratio – A Measure of School’s Profitability

Counts as 30% of Composite Score

Income before Taxes as a Percentage of Total Revenue

Composite Score Scale – Spans -1.0 to +3.0
- +1.5 to +3.0 – Financially Responsible
- +1.0 to +1.5
- “In the Zone” – Financially Responsible, but Additional Oversight Required for up to three years
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- Additional conditions may include: different disbursement of Title IV Funds (i.e., cash monitoring), timely oversight of certain events, possible requests for additional information, shorter deadline to submit financial information, etc.

- Financial Stability
  - -1.0 to +0.9
  - Not Financially Responsible
  - To Continue in Title IV, School Must Post 50% LOC or Accept Provisional Certification plus Post 10% LOC
  - School Still Permitted to Receive Title IV Funds

- Financial Stability
  - School Must Have Sufficient Resources to Make R2T4 Repayment and Timely Refunds
  - School Must be Current in Debt Payments
  - Different Standards Following a Change of Ownership
    - Acid-Test Ratio
    - Tangible Net Worth
  - ED Reserves the Right to Modify Accounting Treatment of Certain Information on Financial Statement
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- What If School’s Financial Statements Do Not Reflect Financial Stability?
  - Do You Have the Most Informative Statements?
    - Informal Income Statement (also called Profit and Loss Statements, or "P&Ls") Can Be Prepared for Any Business Unit
    - Auditors Typically Will Prepare Financial Statements only for a Legal Entity

Is School Part of a Larger Group?
- Is Each School Separately Incorporated / Legally Organized?
- If School Is Part of Corporation / Entity that Has Other Schools or Businesses, Are Financial Problems because of School under Review or Other Business Unit?
- Is there a Parent Entity that Has and Can Provide Resources?

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- Are School Financial Statements Artificially Weak because of Parent Cost Allocation or Financing Policies?

So What?
- Do Financial Statements Indicate that School Is in Danger of Going out of Business?
- Is there Any Indication that the Financial Condition Has Impacted the Quality of Education?
- Is School Making Required Refunds?
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- Are Other Resources Available if School Needs Them?
- Increase Monitoring or Obtain Additional Assurances
  - Has Owner Provided Commitment to Support School or to Close It Responsibly if Circumstances Dictate?
  - Dangers of Creating Burdensome Conditions to Continued Operation

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- Additional Financial Monitoring – ACICS Model
  - Quarterly Financial Report
    - Used When School’s Finances Are Beginning to Show Signs of Weakness or Concern
  - Requires School to Provide Internally Prepared P&L and Balance Sheet 45 Days after Close of Each Fiscal Quarter

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- Financial Improvement Plan
  - Used When School’s Finances Show Significant Weakness or Bad Trajectory
  - Requires School to Project P&L and Balance Sheet Results on Quarterly Basis for Next Fiscal Year
  - Requires School to Provide Internally Prepared P&L and Balance Sheet 45 Days after Close of Each Fiscal Quarter, including Comparison to Projections
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- Financial Show-Cause Directive
  - Used when School’s finances demonstrate significant questions of ability to continue operations
  - Requires School to project P&L and Balance Sheet results on quarterly basis for next fiscal year

- Requires School to provide internally prepared P&L and Balance Sheet 45 days after close of each fiscal quarter, including comparison to projections
- School has opportunity to provide additional written or oral information to demonstrate what it will do to address concerns

Additional Actions

- ACICS may direct a site visit to the School to assess whether financial condition is impacting quality of education or instructional resources
- If so, could lead to loss of accreditation
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- Is Letter of Credit or Some Other Kind of Financial Protection Appropriate?
- Tips for Assessing Financial Responsibility with Limited Staff and/or Expertise
  - Create Uniform System of Assessment – Apples to Apples
  - Utilize Basic Financial Assessment Measures
  - For Title IV Schools, Ask Schools for Composite Scores
  - Develop a Relationship with an Accountant for Complicated Issues

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