

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?

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- 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

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- 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

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- 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

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- 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?

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- 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?

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- 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

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- 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

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- Income before Taxes as a Percentage of Total Revenue
- Counts as 30% of Composite Score
- 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.

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- -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

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- 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

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- 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

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- 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

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- 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 – Applies 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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