Will Your School Financial Statements Meet NACCAS Standards?
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All school owners should know whether their school financial statements meet the requirements of our NACCAS Standard VII, **before** they are submitted to NACCAS for evaluation. This includes schools accredited by NACCAS and those who are seeking accreditation. We also recommend that the school's independent Certified Public Accountant (CPA) become familiar with our requirements, so he or she may properly advise the owner. Let's review the basic criteria:

The financials must be prepared by a CPA who does not have any conflicts of interest with the school that would impair his or her independence. This would include a relationship of employment or a financial interest in the school by the CPA or members of his immediate family. If the school receives federal Title IV student aid, the statements must be audited according to Generally Accepted Government Auditing Standards (GAGAS), which impose a higher standard of responsibility upon the auditor. Schools that do not receive Title IV funding may currently submit CPA-compiled statements to NACCAS. (Please note that in 2011 the Commission is considering a change in Standard VII to require audited statements from all schools.)

The statements must be prepared on an accrual basis in accordance with Generally Accepted Accounting Principles (GAAP). Cash or income tax basis is not acceptable.

They must demonstrate that the institution has sufficient financial resources to ensure continuity of operation, educational programs and services, and to fulfill its obligations to students. This is evaluated based on the following criteria:

(a) Meets the requirements set forth by the U.S. Department of Education in accordance with Section 34 in the Code of Federal Regulations Part 668.171 (b)(1), or the successor regulation, OR

(b) Has a ratio of current assets to current liabilities of at least one to one, AND a positive tangible net worth, AND a profit in the most recent fiscal year or in two of the most recent three fiscal years.

Item (a) refers to the "composite score". The worksheet used for this calculation can be found on our NACCAS website under "Other Resources". Please note that our worksheet is not intended to determine a school's eligibility for Title IV funding through the Department of Education. To meet our standard the school must achieve a score of at least 1.5 (scores range from -1 to 3). Several factors may have a negative impact on the composite score, including:

- High amounts of intangible assets relative to total assets. Intangible assets are those which cannot be converted to cash (e.g., goodwill).

- Large unsecured receivables due from a “related party” (e.g., a loan from the school to the owner, or accounts receivable from companies that are related to the school through common ownership).
- Operating losses

The composite score is designed to assess whether the school has adequate resources available to remain in operation and meet its obligations to students. Intangible assets and unsecured related party receivables are excluded from total assets for purposes of the calculation. The amount of profit or loss is also an important factor. Here are the three major components of the composite score and their assigned weights in the formula:

(1) Primary Reserve Ratio (30%): This compares “Adjusted Equity” to Total Expenses. In other words, what is the financial capacity of the school to meet its current obligations? Adjusted Equity is calculated as follows:

Total Shareholders Equity Stated on Balance Sheet
Minus: Intangible Assets
Minus: Unsecured Related Party Receivables
Minus: Net Fixed Assets
Plus: Long Term Debt (Only up to the amount of net fixed assets. Includes current portion of LTD.)
Plus: Post Employment or Retirement Liabilities (Does not apply to many schools since they generally don’t have defined benefit pension plans)

(2) Equity Ratio (40%): This compares “Modified Equity” to “Modified Assets”. These amounts are the equity and assets as stated on the balance sheet, minus intangible assets and unsecured related party receivables on both sides. In other words, how much “true” equity does the school have, after deducting assets of questionable value?

(3) Net Income Ratio (30%): This compares Pre-Tax Income to Total Revenues. No adjustments are made in these two numbers. This ratio indicates the school’s profitability.

In the worksheet each of these three ratios is assigned a “Strength Factor” between -1 and 3. The Strength Factors multiplied by the relative percentage weights above result in a score for each component. The sum of the component scores is the overall composite score, which must be at least 1.5 to meet NACCAS Standard VII.

If a school does NOT achieve the required composite score, it must meet ALL three of the alternative criteria described at the beginning of this article. This includes having current assets at least equal to current liabilities, positive **tangible** net worth, and a profit in the most recent accounting year or in two of the most recent three fiscal years. Schools with low composite scores (between -1 and 1) usually also have difficulty in meeting the alternative criteria.

To receive accreditation from NACCAS a school must comply with all our Standards. The Commission does deny initial accreditation to schools because they fail to meet our financial criteria. Additionally, our accredited institutions are required to submit their audited financial statements to NACCAS within six months of their fiscal year end. If they don't meet Standard VII the Commission will place the school on financial monitoring. Under Section 8.18 of our Rules the institution has only a limited period of 12, 18, or 24 months to bring itself back into compliance, depending on the length of its longest program.

We realize there are many NACCAS Standards and other regulations when operating a school. It can be easy to ignore our financial requirements until it's too late. Each school should prepare internal statements at least quarterly and determine whether it's likely to meet the 1.5 composite score or alternate criteria at the end of the fiscal year. If it appears your school is not on the right track, you may want to ask your CPA whether any actions can be taken to stay in compliance with NACCAS Standard VII. This may involve reduction of expenses and/or investment of additional equity in the company. NACCAS is not permitted to recommend a specific course of action for your school. If you have questions on our requirements for school financial statements, please contact our Director of Finance, Len Grus, CPA, at (703) 600-7600 x132 or lgrus@naccas.org.