Although home study institutions rarely change hands, periodic internal valuations of the financial worth of home study schools can be instructive for school owners. The first step is to determine the school's position in the context of the education field. This can be accomplished by asking 10 questions that a potential buyer of the school might ask. The next step--product valuation--is accomplished by determining the value of the school's product (its course materials and the support services included in offering a course for enrollment) and the educational worth of the school's courses. Courses' perceived educational value may be assessed by using the rating form used by examiners of the National Home Study Council's accrediting commission. Analyzing the school's balance sheet is the most complicated, confusing, and important part of any analysis of a school's worth. It is important that balance sheet entries be examined carefully by using prescribed questions regarding the following balance sheet sections/items: accounts receivable; cash section; inventory; plant and equipment; accounts payable; debt; and entries pertaining to things such as goodwill, royalty payments, and impending litigation. The school's income statement should be analyzed to identify trends in the school's income and expenses. (MN)
Evaluating Your School's Worth

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)

This document has been reproduced as received from the person or organization originating it.

Minor changes have been made to improve reproduction quality.

Points of view or opinions stated in this document do not necessarily represent official OERI position or policy.

"PERMISSION TO REPRODUCE THIS MATERIAL HAS BEEN GRANTED BY

[Signature]

TO THE EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)."
NHSC OCCASIONAL PAPER
NUMBER 7

by

Michael P. Lambert
Executive Director
National Home Study Council

Printed by McGraw-Hill Continuing Education Center
Washington, D.C.

Published by the National Home Study Council,
Washington, D.C.

July 1992

NHSC OCCASIONAL PAPERS are essays intended to stimulate and encourage candid exchanges of ideas between home study professionals. For a complete set of Occasional Papers, write or call the NHSC.
Introduction

This Occasional Paper answers the question, "How do you put a value or sales price on a correspondence school?"

Home study institutions rarely change ownership—perhaps an average of only one accredited school has changed hands each year over the past decade. Each transaction is unique, and general rules about valuation are speculative.

Periodically, it can be instructive for private home study school owners to do a confidential internal valuation of the worth of their institution—to take stock, as it were, of the potential sales price of their school, just in case it becomes advisable to sell when outside events move too rapidly. Such valuation exercises can also help in strategic planning and in securing external financing.

Let's begin by listing possible questions to consider concerning the school and its overall position in the education marketplace.

The School’s Position in the Overall Field

One way to approach the task of valuating your school's worth is to look at the institution in the context of the education field. Assume that you are a potential buyer of your own school. What questions would you ask? Perhaps these:

1. What has been the history of the school since its founding in terms of different owners, changes in senior officers, or the management team? How many potential new owners have tried to acquire the school?

2. Concerning top school management, what has been their longevity, quality, intensiveness, concentration, esprit de corps, and management succession?

3. What are the internal and external trends (regulatory, federal aid, etc.) and probable events that will have a significant influence on futures sales and earnings?
4. What has been the school's track record with respect to legal/regulatory problems, student complaints, state agency actions, or problems with accrediting agencies? Has the school been a target of regulatory bodies?

5. What is the school's competitive position in the home study field? In its course product arena? In the private school field? Has its position been improving or deteriorating in the past five years?

6. Historically, what have been the school's reasons for growth, e.g., unique competitive position, acquisitions, far-sighted management, federal student aid availability, fortuitous course development, aggressive marketing, etc.?

7. How well has the school articulated its overall mission statement? How well has it been able to meet its mission over the years? Is the mission translated into consistently achieved goals?

8. What is the overall outlook for the demand for the school's courses over the next five years? Has the school been aggressive in identifying new courses and in capitalizing on emerging markets?

9. What has caused any significant changes in the number and size of competitors over the past 10 years? New entrants—shakeouts or closures/acquisitions?

10. What "goodwill" has the institution earned over the years? How has it earned this "goodwill"? What is its reputation within the home study field?

**Product Valuation: How Good Are the Courses?**

Let us turn our attention to the topic of how school owners might set a value on their school's product: the course materials and support services included in offering a course for enrollment.
Financial Worth of Product

Perhaps the most important part of product valuation is establishing a realistic financial worth of your institution’s courses.

Such questions as these can help in reaching a realistic value for each course:

- What percent of revenue is generated from courses or products introduced within the past five years?
- What percent of revenue is generated from courses or products that are six to ten years old?
- What is the short and long term revenue trend of each course or product?
- What new courses or products are planned for introduction within the next 12 months . . . 24 months . . . 36 months?
- What is the projected revenue from these planned new courses or products?
- What is the course’s tuition collection percentage for time payment pains?

In looking at a course product’s financial worth from a school buyer’s perspective, the logical questions include:

- What would it cost to develop the course “from scratch” today? What did it actually cost to develop the course? How were these costs amortized?
- What royalties, publishing rights or ancillary equipment are needed to support the course? Are there legal entanglements concerning course ownership?
- What percentage of the home study market does the course have? Has this percentage been growing or shrinking in the past three years?
- Is there an adequate inventory of course product on hand to service foreseeable new enrollments?

**Educational Worth of the Courses**

There are important questions to be raised about a course's perceived educational value. True, any product is worth what someone else is willing to pay for it, but having a feeling for the "educational value" of a home study course can help establish a fair sales price for it as well as for the overall school.

Using the Accrediting Commission's *Rating Form for Examiners*, ask yourself such questions as:

1. Is the course up to date? Written by knowledgeable persons?
2. Does the course deliver on what it promises students?
3. Do course assignments adequately measure the learner's mastery of learning objectives?
4. What is the course's track record in outcomes assessment, e.g., placement of graduates? What do institutional surveys of graduates and employers reveal?
5. What are the course non-start, lesson completion and graduation rates? Are these rates "competitive" in the home study field?
6. What are the costs associated with servicing the course, i.e., cost per lesson to grade, number and cost of letter and phone inquiries per student, etc.?
7. Are course graduates well received by employers and other interested agencies and educational institutions?
8. Are student complaints about the course minimal?
9. Does the course require special faculty, "heavy" personal service and grading, or unusual post-enrollment follow-ups?
10. What are the costs for developing servicing systems, i.e., software, computers, academic records, etc.? Home study courses require support systems, and there should be a value placed on the development costs not only for the product, but also for the software and service needs which support the product.

The questions above are just a few of the more obvious ones to be considered in coming to a judgment on what a course is worth.

**Analyzing the Balance Sheet**

Now, let's discuss techniques of analyzing a balance sheet, perhaps the most complicated, confusing and important part of any analysis of what a school is worth.

Financial analysis relies heavily on the quality and integrity of the financial statements of the institution. As a minimum, the statements—to attain a threshold level of credibility—should be prepared by an independent, CPA in accordance with "generally accepted accounting principles." This means, for example, that the statements are prepared using the accrual method of accounting.

The Balance Sheet is best described as a "snap shot" of a business activity on a given day. It is not considered to be a reliable indicator of how well a business is doing. Analysts look at it for exceptions, surprises or unusual or unique features of the business. Let's look at some selected components of the balance sheet from a home study analyst/prospective buyer's point of view. We will focus on questions unique to home study that might be raised by a buyer of a school.

**Questioning Balance Sheet Entries**

In looking at the balance sheet, the critical item is the accounts receivable. How are accounts receivable determined? How is income recognized? How is bad debt established? Are reserves set aside for future service, refunds, and bad debt? Often footnotes are cleverly worded to mask the "real situation." Analysis of the accounts receivable, particularly the question of how and when income is recognized, is all important.
Here are other questions for accounts receivable analysis:

- How are accounts aged?

- What is the school's historic tuition collection percentage?

- Is the reserve for bad debt realistic?

- How are bad debts written off?

- Are students contracts (i.e., future services due to students) adequately protected by reserves?

- Are tuition collection efforts ethical, professional and effective?

- Are there non-tuition accounts receivable? How is income recognized for them?

In looking at the cash section of the balance sheet:

- Are bank account balances verifiable?

- Are funds tied up in long term time deposits (CD's)?

- Are there Trust funds or sinking funds? Are they being funded fully and on time?

- Are there adequate credit lines with banks?

- What is the school's track record in being able to secure loans from its bank(s)?

- Are marketable securities fairly and consistently valued?

- How quickly can "near cash" investments be converted into cash?

- Have school assets been financed primarily through operational earnings or through debt financing/external borrowings?
Regarding inventory, ask these questions:

- What is the method of inventory valuation, LIFO, FIFO, etc.
- Is inventory valued at actual cost or market?
- Is inventory (e.g., lesson materials) on-hand adequate to service currently enrolled students?
- Is inventory up to date and well maintained?
- Examine print dates on course materials. Do they support claims of continuous and timely product revisions?

Regarding plant and equipment:

- Are offices owned? Who owns them? Are they leased? When are leases renewable?
- Are computers owned or leased? Are computers up to date? Is software current, and able to meet near term needs?
- What are the policies for capitalizing assets?
- What is the depreciation method used?
- Are current facilities adequate to meet forecasted enrollments?

Concerning accounts payable, ask:

- How “old” are the accounts? Are any short term payables older than the normal cycle?
- Obtain a list of current accounts payable. Are vendors and creditors being paid on time?
- Are payroll taxes current?

In looking at debt, consider:

- What are maturity dates for outstanding debt?
- Any loans from owners?
- Any liens on the school assets to secure debt?
- Are state and federal payroll taxes current?
- Are funded pension plans, medical plans, etc. current?
- Are staff and sales representatives always paid on time?

In other areas, consider:

- Scrutinize carefully the explanations given in “notes to the financial statement.” Explanatory notes can be a gold mine of revealing information on what is really going on in any company.
- Is “goodwill” defensible and realistic?
- Are course products subject to the royalty payments? (Who owns the courses?)
- Is there impending litigation or governmental investigations or audits which will impact the school?
- Over the years, has equity increased through operating profits or through investments?

Analyzing the Income Statement

Now let's look at the Income Statement from the perspective of a home study school financial analyst. We need to remember that Income Statements are “score cards” of how a school has done over a period of time, usually twelve month period such as January 1st to December 31st. Balance Sheets are a “snap shot” of a given day, but the Income Statement covers a period of school operations in which revenue is matched against expenses.

Generally speaking, the Income Statement is more important than the Balance Sheet. The Income Statement is straightforward: revenue is shown first, then expenses are listed and deducted. The Income Statement answers one basic question, “How much profit did we make?”
Here are sample questions an analyst might ask in evaluating a home study school's Income Statement:

1. How is revenue recognized, on the accrual basis or on the cash basis? (Generally Accepted Accounting Principles--as well as the NHSC Accrediting Commission--require the use of accrual accounting). If the cash basis is used, why? A statement prepared using the cash basis can give a distorted picture, since cash accounting fails to match revenue in a period with the expenses that were incurred in that period to generate the revenue.

2. Go behind the total revenue figure listed (by looking at the ledgers) to see what course products contributed to the income/revenue. Often, 70% of the revenue will be generated by just 30% of the product line. The next logical question is, "Should some courses be dropped if they cost more to sell and service than they are generating in revenue?"

3. Analyze the source of revenue again. What percent is from cash-paying students, what percent is from corporate tuition reimbursement programs, what percent is government financing, etc.? The revenue figures should be evaluated in light of the "external environment"--with cash-paying students being the most reliable source of revenue today and corporately sponsored accounts the most collectable.

4. How does the Income Statement account for reserves for bad debts, for returns, or refunds? How are such factors recognized?

5. Examine the revenue figure in terms of the percentage of contract value which is not--historically--ever going to be collected. A classic error in analyzing accrual statements is to assume that home study schools collect 100% of the enrollment contract's stated tuition amount. They do not. Schools are fortunate to collect 50-60% of the contract value. How is the "non-collection" amount recorded or recognized in the total revenue figure?
6. In other words, net revenue—in one fashion or another—must reflect the influence of at least four factors to present a realistic net revenue figure: cost of goods sold, bad debt, refunds, and non-collection rate. (For example, some schools elect to use a modified accrual method of income recognition. Other schools do not book revenue until after the student studies a given percentage of lessons.)

7. The next section of the Income Statement, the Operating Expenses, is usually a straightforward listing of sundry business expenses. Good questions to ask include:

a. How are expenses allocated, e.g., are executive salaries split up among different functions?

b. Are any costs (e.g., course development) being deferred to a future time?

c. Are travel and entertainment accounts realistic?

d. Are there any “one time only” costs anticipated?

e. Are “administrative expenses” and “selling expenses” logically allocated?

f. Are there logical, academically sound entries for student services and course development costs versus selling expenses? In other words, does the school spend too much on promotion and too little on education? Such an imbalance can result in future problems.

8. What is the historic gross profit of the school’s Income Statements? What has been the school’s historic percentage of income before taxes?

9. Analyze the trend in marketing expenses for the past three years. Has it been at a consistent level? A school which wants to show a good balance sheet (and abnormally high profits) need only eliminate its advertising—past student contracts continue to generate income, and the heavy expense of advertising is elimi-
nated in order to show a misleading picture of a school's financial health.

10. Finally, conduct the usual ratio analyses of the Income Statement common to all financial statement analysis. Look for trends and marked differences from year to year. Are sales declining? Are profits slipping? Are expenses out of proportion to the sales being generated? Try to ascertain why.

Summary

Your institution may never change ownership. However, school owners need to have a sense of what value to place on their school as they plan for the future. The questions listed in this Occasional Paper are intended to aid school owners in making realistic assessments of their institution's overall worth. In the final analysis, what a school is worth is what someone is willing to pay for it.
About the Author

Michael P. Lambert holds graduates degrees in Business Administration and in English. He joined the NHSC in 1972 as Accrediting Program Coordinator, was named Assistant Director in 1977, Associate Director in 1987, and Executive Director in 1992.

He attended the Indiana University of Pennsylvania, George Mason University, Virginia, and Cambridge University, England. He served in the Army as an education and training officer, and he also served as an operations officer during his Army Reserve duty. He has taught at the secondary and college levels.

Mr. Lambert has served on more than 400 accreditation examination committees. He has authored or edited numerous books and articles on correspondence education and accreditation, including correspondence courses on effective writing, new course planning, and business standards. In 1989, he authored the first NHSC Occasional Paper entitled, Student Services: Achilles Heel or Crown Jewel?
Other Occasional Papers Available

Number One--Student Services: Achilles Heel or Crown Jewel? by Michael P. Lambert, NHSC's Executive Director

Number Two--What Manger Doesn't Study at Home? by Dr. Gordon Wills, Principal, The International Management Centres

Number Three--Toward Better Service and Testing by Dennis Foltz, Vice President of Education and Operations, Gemological Institute of America

Number Four--Testing Home Study Advertising by Jack Thompson, Consultant

Number 5--Conducting Graduate Surveys by Mary McKeown, Vice President, American School

Number 6--Enrollment Contracts for Home Study Schools by William Wright, President, American School
NOTICE

REPRODUCTION BASIS

This document is covered by a signed "Reproduction Release (Blanket)" form (on file within the ERIC system), encompassing all or classes of documents from its source organization and, therefore, does not require a "Specific Document" Release form.

This document is Federally-funded, or carries its own permission to reproduce, or is otherwise in the public domain and, therefore, may be reproduced by ERIC without a signed Reproduction Release form (either "Specific Document" or "Blanket").