

§ 668.23 Compliance audits and audited financial statements.

(a) General-

(1) Independent auditor. For purposes of this section, the term “independent auditor” refers to an independent certified public accountant or a government auditor. To conduct an audit under this section, a government auditor must meet the Government Auditing Standards qualification and independence standards, including standards related to organizational independence.

(2) Institutions. An institution that participates in any title IV, HEA program must at least annually have an independent auditor conduct a compliance audit of its administration of that program and an audit of the institution's general purpose financial statements.

(3) Third-party servicers. Except as provided under this part or 34 CFR part 682, with regard to complying with the provisions under this section a third-party servicer must follow the procedures contained in the audit guides developed by and available from the Department of Education's Office of Inspector General. A third-party servicer is defined under § 668.2 and 34 CFR 682.200.

(4) Submission deadline. Except as provided by the Single Audit Act, Chapter 75 of title 31, United States Code, an institution must submit annually to the Secretary its compliance audit and its audited financial statements **no later than by the date that is the earlier of (i) 30 days following the date of the auditor's report or six months after the last day of the institution's fiscal year, or (ii) 30 days after the date of the later auditor's report with respect to the compliance audit and audited financial statements.**

(5) Audit submission requirements. In general, the Secretary considers the compliance audit and audited financial statement submission requirements of this section to be satisfied by an audit conducted in accordance with the Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, or the audit guides developed by and available from the Department of Education's Inspector General, whichever is applicable to the entity, and provided that the Federal student aid functions performed by that entity are covered in the submission. (Both OMB circulars are available by calling OMB's Publication Office at (202) 395-7332, or they can be obtained in electronic form on the OMB Home Page (<http://www.whitehouse.gov>).

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(d) Audited financial statements -

(1) *General.* To enable the Secretary to make a determination of financial responsibility, an institution must, to the extent requested by the Secretary, submit to the Secretary a set of financial statements for its latest complete fiscal year, as well as any other documentation the Secretary deems necessary to make that determination. Financial statements submitted to the Secretary must be prepared on an accrual basis in accordance with generally accepted accounting principles, and audited by an independent auditor in accordance with generally accepted government auditing standards, issued by the Comptroller General of the United States and other guidance contained in the Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations; or in audit guides developed by, and available from, the Department of Education's Office of Inspector General, whichever is applicable. As part of these financial statements, the institution must include a detailed description of related entities based on the definition of a related entity as set forth in the Statement of Financial Accounting Standards (SFAS) 57. The disclosure requirements under this provision extend beyond those of SFAS 57 to include all related parties and a level of detail that would enable to Secretary to readily identify the related party. Such information may include, but is not limited to, the name, location and a description of the related entity including the nature and amount of any transactions between the related party and the institution, financial or otherwise, regardless of when they occurred. **If there are no related party transactions, then a footnote must be added to disclose this**

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fact.

(2) Submission of additional financial statements information.

(i) To the extent requested by the Secretary in determining whether an institution is financially responsible, the Secretary may also require the submission of audited consolidated financial statements, audited full consolidating financial statements, audited combined financial statements or the audited financial statements of one or more related parties that have the ability, either individually or collectively, to significantly influence or control the institution, as determined by the Secretary.

(ii) For a domestic or foreign institution that is owned directly or indirectly by any foreign entity or individual holding at least a 50 percent voting or equity interest in the institution, the institution must provide documentation of the entity's status under the law of the jurisdiction under which the entity is organized, to include, at a minimum, the date of organization, a current certificate of good standing and a copy of the authorizing statute for such entity status. The Secretary may also require the submission of additional documents related to the entity's status under the foreign jurisdiction as needed to assess the entity's financial status. Documents must be translated into English.

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SUBPART L - FINANCIAL RESPONSIBILITY

§ 668.171 General.

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(b) General standards of financial responsibility. Except as provided under paragraphs ~~(c), (d), and~~ (h) of this section, the Secretary considers an institution to be financially responsible if the Secretary determines that -

(1) The institution's Equity, Primary Reserve, and Net Income ratios yield a composite score of at least 1.5, as provided under § 668.172 and appendices A and B to this subpart;

(2) The institution has sufficient cash reserves to make required returns of unearned title IV, HEA program funds, as provided under § 668.173;

(3) The institution is able to meet all of its financial obligations and provide the administrative resources necessary to comply with title IV, HEA program requirements. An institution is not deemed able to meet its financial or administrative obligations if -

(i) It fails to make refunds under its refund policy, ~~or~~ return title IV, HEA program funds for which it is responsible under § 668.22, or pay title IV credit balances as required under § 668.164(h)(ii);

(ii) It fails to make repayments to the Secretary for any debt or liability arising from the institution's participation in the title IV, HEA programs;

(iii) It fails to make a payment in accordance with an existing undisputed financial obligation for more than 90 days;

(iv) It fails to satisfy make payroll obligations per in accordance with its published payroll schedule;

(v) It borrows funds from retirement plans or restricted funds without authorization; or

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~~(viii)~~ It is subject to an action or event described in paragraph (c) of this section (mandatory triggering events), or an action or event that the Secretary determines is likely to have a material adverse effect on the financial condition of the institution under paragraph (d) of this section (discretionary triggering events); and

(4) The institution or persons affiliated with the institution are not subject to a condition of past performance under § 668.174(a) or (b).

(c) Mandatory triggering events. After reviewing information provided by an institution under paragraph (f)(3), the Secretary may reach a final determination that an institution is not able to meet its financial or administrative obligations under paragraph (b)(3)~~(viii)~~ of this section if -

~~(1) After the end of the fiscal year for which the Secretary has most recently calculated an institution's composite score, o~~One or more of the following occurs:

(i) Debts, liabilities, and losses.

~~(A) After the end of the fiscal year for which the Secretary has most recently calculated an institution's composite score if the institution's composite score was less than 1.5, or the institution or any individual or entity described in subparagraph (B) or (C) of this section, the institution is required to pay any material debt or incurs any material liability that is not indemnified by a third party from a settlement, arbitration proceeding, final judgment in a judicial proceeding, or final determination arising from an administrative or judicial action or proceeding initiated by a Federal or State entity proceeding described in subparagraph (B) or (C), and as a result of the debts, liabilities, or losses that have stemmed from those actions or events, the institution's recalculated composite score is less than 1.0, as determined by the Secretary under paragraph (e) of this section. For the purposes of this paragraph, the word "material" means an amount equal to or greater than 5 percent of the title IV, HEA program funds received by the institution during its most recently completed fiscal year.~~

~~A determination arising from an administrative action or proceeding initiated by a Federal or State entity means the determination was made only after an institution had notice and an opportunity to submit its position before a hearing official. A final determination arising from an administrative action or proceeding initiated by a Federal entity includes a final determination arising from any administrative action or proceeding initiated by the Secretary. For purposes of this section, the liability is the amount stated in the final judgment or final determination. A judgment or determination becomes final when the institution does not appeal or when the judgment or determination is not subject to further appeal;~~

~~(B) The institution or any entity whose financial statements were submitted in the prior fiscal year to meet the requirements of § 668.23, or in the year following a change in ownership, the entity whose financial statements were submitted to meet the requirements of § 600.20(g) or (h), is being sued for financial relief in an action brought on or after July 1, 2023, by a Federal or State authority, or through a qui tam lawsuit in which the Federal government has intervened, and the suit has been pending for 120 270 days, and the amount in controversy as alleged in the most recently updated complaint is equal to or greater than 5 percent of the title IV, HEA program funds received by the institution during its most recently completed fiscal year; or~~

~~(C) The Secretary has adjudicated claims in favor of borrowers under the loan discharge provisions in 34 CFR part 685 and the total amount of the loans discharged since July 1, 2023, is equal to or greater than 5 percent of the title IV, HEA program funds received by the institution during its most recently completed fiscal year.~~

~~(Bii) Withdrawal of owner's equity.~~

~~(A) For a proprietary institution whose composite score is less than 1.5, there is a~~

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withdrawal of owner's equity ~~from the institution~~ by any means, including by declaring a

~~dividend (e.g., a capital distribution that is the equivalent of wages in a sole proprietorship or partnership, a distribution of dividends or return of capital, or a related party receivable), unless the withdrawal is a transfer to an entity included in the affiliated entity group on whose basis the institution's composite score was calculated; or is the equivalent of wages in a sole proprietorship or general partnership or a required dividend or return of capital; and~~

~~(#B) As a result of that liability or withdrawal, the institution's recalculated composite score, or in the year following a change in ownership, the recalculated composite score for the entity whose financial statements were submitted to meet the requirements of § 600.20(g) or (h) is less than 1.0, as determined by the Secretary under paragraph (e) of this section.~~

(iii) Gainful employment.

~~(A) As determined annually by the Secretary, the institution has gainful employment programs that, under § 668.403, could become ineligible based on their final D/E rates for the next award year; and~~

~~(B) The title IV, HEA program funds in those program funds total at least ~~40~~ 50 percent of the title IV, HEA program funds the institution received in its most recently completed fiscal year for those GE programs.~~

~~(iv#) Teach-out plans. The institution is required to submit a teach-out plan and/or agreement, for a reason described in 34 CFR 602.24(c)(1) and (c)(2)(ii)-(v), that covers the closing of the institution or any of its branches or additional locations.~~

~~(iv) State actions. The institution is cited by a State licensing or authorizing agency for failing to meet material State or agency requirements and the agency provides notice that it will withdraw or terminate the institution's licensure or authorization if the institution does not take the steps necessary to come into compliance with that requirement.~~

~~(2v) Publicly listed/traded entities/institutions. An institution that is directly or indirectly owned at least 50 percent by an entity that is listed on a domestic or foreign exchange. A publicly traded institution is subject to one or more of the following actions or events:~~

~~(iA) SEC actions. The U.S. Securities and Exchange Commission (SEC) issues an order suspending or revoking the registration of the institution's securities pursuant to Section 12(j) of the Securities and Exchange Act of 1934 (the "Exchange Act") or suspends trading of the institution's securities on any national securities exchange pursuant to Section 12(k) of the Exchange Act.; or~~

~~(iB) Exchange actions. The national securities exchange on which the entity's/institution's securities are traded/listed notifies the entity/institution that it is not in compliance with any material the exchange's listing requirements and, as a result, the institution's/or its securities are delisted, either voluntarily or involuntarily, pursuant to the rules of the relevant national securities exchange.~~

~~(iC) SEC reports. The entity/institution failed to file a required annual or quarterly report with the SEC within the time period prescribed for that report or by any extended due date under 17 CFR 240.12b-25, and did not issue an extension to file the report.~~

Commented [A1]: Under our proposed GE redline, this reference would need to be changed to 668.502 under our subpart F

Commented [A2]: This proposed change is consistent with the Department's proposal in 668.16(m) regarding administrative capability

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(D) Foreign Exchanges. If the entity is subject to an event, notification, or condition by a foreign exchange that the Secretary determines is equivalent to those identified in (A)–(C) above.

(vii) Non-Federal educational assistance funds. For its most recently completed fiscal year, a proprietary institution did not receive at least 10 percent of its revenue from sources other than Federal educational assistance, as provided under § 668.28(c). The surety financial protection provided under this requirement will remain in place until the institution passes the 90/10 revenue requirement for two consecutive years;

(viii) Cohort default rates. The institution's two most recent official cohort default rates are 30 percent or greater, as determined under subpart N of this part, unless –

(A) The institution files a challenge, request for adjustment, or appeal under subpart N of this part with respect to its rates for one or both of those fiscal years; and

(B) That challenge, request, or appeal remains pending, results in reducing below 30 percent the official cohort default rate for either or both of those years, or precludes the rates from either or both years from resulting in a loss of eligibility or provisional certification. ~~or~~

(ix) Loss of eligibility. The institution has lost eligibility to participate in another Federal educational assistance program due to an administrative action against the school, and the Secretary has assessed the nature of the administrative action and determined that it is material and substantially impedes the institution's ability to perform its obligations under title IV.

(xvi) Contributions and distributions.

(A) An institution's financial statements required to be submitted under § 668.23 reflect an institution made a contribution in the last quarter of the fiscal year, and the institution then made a distribution during the first two quarters of the next fiscal year; and

(B) The removal of such contribution up to the amount of the distribution results in a recalculated composite score of less than 1.0, as determined by the Secretary under paragraph (e) of this section.

(xi) Creditor events.

(A) As a result of an action taken by the Department, the institution or any entity included in the financial statements submitted under § 668.23 is subject to a default or other condition under a line of credit, loan agreement, security agreement, or other financing arrangement; or

(B) Any creditor terminates, withdraws, limits, or suspends any line of credit, loan agreement, or other financing arrangement because the institution is in financial distress.

(32) After the end of the fiscal year for which the Secretary has most recently calculated an institution's composite score, when in the fiscal year following the fiscal year for which the Secretary has most recently calculated an institution's composite score, if the institution is becomes subject to two or more unresolved discretionary triggering events, as defined in paragraph (d) of this section, those events become mandatory triggering events, unless a triggering event is resolved before any subsequent event(s) occurs. 60 days following the second triggering event if both triggering events remain unresolved. All further discretionary triggering events during that fiscal year become mandatory triggering events, even if both of the two original triggering events are resolved.

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(d) Discretionary triggering events. The Secretary may determine that an institution is not able to meet its financial or administrative obligations under paragraph (b)(3)(~~iv~~) of this section if any of the following events is likely to have a material adverse effect on the financial condition of the institution -

(1) ~~Accrediting agency actions.~~ The institution ~~is or was an accrediting agency that has placed or places the institution on probation or issued a show-cause order, or placed or places the institution on an accreditation status that poses an equivalent or greater risk to its accreditation, by its accrediting agency, for failing to meet one or more of the agency's~~ accrediting agency for the institution issued an order, such as a show-cause order or similar action, that, if not satisfied, could result in the withdrawal, revocation or suspension of institutional accreditation for failing to meet one or more of the agency's standards; ~~This provision does not apply to actions taken by a programmatic accreditor that is not serving as the institution's title IV, HEA gatekeeper.~~

(2) ~~Violation of a loan agreement~~ ~~Creditor events.~~

(i) ~~The institution violated a provision or requirement in a security or loan agreement with a creditor; and (i) Except as provided above in (c)(1)(xi), the institution or any entity included in the financial statements submitted under § 668.23 is subject to a default or other condition under a line of credit, loan agreement, security agreement, or other financing arrangement; and~~

(ii) ~~As provided under the terms of that line of credit, loan agreement, security agreement, or other financing arrangement~~ ~~security or loan agreement~~, a monetary or nonmonetary default or delinquency event occurs, or other events occur, that trigger or enable the creditor to require or impose on the institution ~~or any entity included in the financial statements submitted under § 668.23 or Subpart I~~, an increase in collateral, a change in contractual obligations, an increase in interest rates or payments, or other sanctions, penalties, or fees;

(3) ~~The institution's State licensing or authorizing agency notified the institution that it has violated a State licensing or authorizing agency requirement and that the agency intends to withdraw or terminate the institution's licensure or authorization if the institution does not take the steps necessary to come into compliance with that requirement;~~

(4) ~~For its most recently completed fiscal year, a proprietary institution did not receive at least 10 percent of its revenue from sources other than title IV, HEA program funds, as provided under § 668.28(c);~~

(3) ~~Fluctuations~~ ~~Significant Declines~~ ~~in Title IV volume.~~ There is a significant ~~fluctuation between decline in consecutive award years, or a period of award years,~~ in the amount of Direct Loan or Pell Grant funds, ~~or a combination of those funds, received by the institution that cannot be accounted for by changes in those programs or other macroeconomic conditions that is equal to or greater than 25 percent of the title IV, HEA program funds received by the institution during its most recently completed fiscal year;~~

~~(4) High annual dropout rates.~~ As calculated by the Secretary, the institution has high annual dropout rates; ~~or~~

(6) ~~The institution's two most recent official cohort default rates are 30 percent or greater, as determined under subpart N of this part, unless~~

~~(i) The institution files a challenge, request for adjustment, or appeal under that subpart with respect to its rates for one or both of those fiscal years; and~~

~~(ii) That challenge, request, or appeal remains pending, results in reducing below 30 percent the official cohort default rate for either or both of those years, or precludes the rates from either or both years from resulting in a loss of eligibility or provisional certification.~~

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(5) *Interim reporting.* For an institution required to provide additional financial reporting to the Department due to a failure to meet the financial responsibility standards in Subpart L or due to a change in ownership, there are negative cash flows, failure of other liquidation ratios, cash flows that significantly miss the projections submitted to the Department, ~~or~~ withdrawal rates that increase significantly; or other indicators of a material change in the financial condition of the institution;

(6) *Pending borrower defense claims.* The Secretary has pending claims for borrower relief discharge under § 685.206 and has formed a group process to consider claims under § 685.402, and has determined that it may legally seek recovery of claims from the institution that are equal to or greater than 5 percent of the title IV, HEA program funds received by the institution during its most recently completed fiscal year.

(7) *Discontinuation of programs.* The institution discontinues a significant share most of its academic programs; ~~or~~

(8) *Closures of locations.* The institution closes most of its locations, or obtains approval from the Department to close most or all of its ground-based locations while maintaining an online program - within two consecutive institutional fiscal years and such changes cause a 25 percent or more decline in enrollment or decreases revenue by 25 percent or more.

(9) *State citations.* The institution is cited by a State licensing or authorizing agency for failing to meet State or agency requirements; or

(10) *Short-term borrowing.* An institution's financial statements required to be submitted under § 668.23 or Subpart L include a line of credit or loan borrowing in the last quarter of the fiscal year, and was then repaid the loan during the first two quarters of the next fiscal year.

(e) Recalculating the composite score. The Secretary recalculates an institution's most recent composite score by recognizing the actual amount of the liability, or cumulative liabilities, incurred by an institution under paragraph (c)(1)(i)(A) of this section as an expense or accounting for the actual withdrawal, or cumulative withdrawals, of owner's equity under paragraph (c)(1)(ii) ~~(B)~~ of this section as a reduction in equity, and accounts for that expense or withdrawal by -

(1) For liabilities incurred by a proprietary institution, liabilities incurred by the entity whose financial statements were submitted in the prior fiscal year to meet the requirements of § 668.23, or in the year following a change in ownership, the entity whose financial statements were submitted to meet the requirements of § 600.20(g) or (h) will be adjusted as follows:

- (i) For the primary reserve ratio, increasing expenses and decreasing adjusted equity by that amount;
- (ii) For the equity ratio, decreasing modified equity by that amount; and
- (iii) For the net income ratio, decreasing income before taxes by that amount;

(2) For liabilities incurred by a non-profit institution, liabilities incurred by the entity whose financial statements were submitted in the prior fiscal year to meet the requirements of § 668.23, or in the year following a change in ownership, the entity whose financial statements were submitted to meet the requirements of § 600.20(g) or (h) will be adjusted as follows:

- (i) For the primary reserve ratio, increasing expenses and decreasing expendable net assets by that amount;
- (ii) For the equity ratio, decreasing modified net assets by that amount; and
- (iii) For the net income ratio, decreasing change in net assets without donor restrictions by that amount; and

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(3) For a proprietary institution, the withdrawal of equity in the entity whose financial statements were submitted in the prior fiscal year to meet the requirements of 668.23, or in the year following a change in ownership, the entity whose financial statements were submitted to meet the requirements of 600.20(g) or (h) will be adjusted as follows: For the amount of owner's equity withdrawn from a proprietary institution -

- (i) For the primary reserve ratio, decreasing adjusted equity by that amount; and
- (ii) For the equity ratio, decreasing modified equity by that amount.

(f) Reporting requirements.

(1) In accordance with procedures established by the Secretary, an institution must notify the Secretary of the following actions or events -

(i) For a liability incurred under paragraph (c)(1)(i)(A) of this section, no later than 10 days after the date of written notification to the institution or entity of the final judgment or final determination;

(ii) For a lawsuit under paragraph (c)(1)(i)(B) of this section, no later than 10 days after the institution or entity is served with the complaint, and an updated notice must be provided and 10 days after the suit has been pending for 120 days;

(iii) For a withdrawal of owner's equity described in paragraph (c)(1)(i)(B) of this section -

~~(A)~~ For a capital distribution that is the equivalent of wages in a sole proprietorship or general partnership, no later than 10 days after the date the Secretary notifies the institution that its composite score is less than 1.5. In response to that notice, the institution must report the total amount of the wage-equivalent distributions it made during its prior fiscal year and any distributions that were made to pay any taxes related to the operation of the institution. During its current fiscal year and the first six months of its subsequent fiscal year (18-month period), the institution is not required to report any distributions to the Secretary, provided that the institution does not make wage-equivalent distributions that exceed 150 percent of the total amount of wage-equivalent distributions it made during its prior fiscal year, less any distributions that were made to pay any taxes related to the operation of the institution. However, if the institution makes wage-equivalent distributions that exceed 150 percent of the total amount of wage-equivalent distributions it made during its prior fiscal year less any distributions that were made to pay any taxes related to the operation of the institution at any time during the 18-month period, it must report each of those distributions no later than 10 days after they are made, and the Secretary recalculates the institution's composite score based on the cumulative amount of the distributions made at that time;

~~(B)~~ For a distribution of dividends or return of capital, no later than 10 days after the dividends are declared or the amount of return of capital is approved; or

~~(C)~~ For a related party receivable, not later than 10 days after that receivable occurs;

(iv) For a contribution and distribution under paragraph (c)(1)(~~iii~~) and the short-term borrowing provision in paragraph (d)(6), not later than 10 days following each transaction.

(vi) For the provisions relating to a publicly traded entity/institution under paragraph (c)(1)(v) of this section, no later than 10 days after the date that the event described under paragraph (c)(1)(vi) occurs. -

(A) The SEC issues an order suspending or revoking the registration of the institution's securities pursuant to Section 12(j) of the Exchange Act or suspends trading of the institution's securities on any national securities exchange pursuant to Section 12(k) of the Exchange Act; or

(B) The national securities exchange on which the institution's securities are traded listed warns notifies the institution of noncompliance with the rules of the relevant national securities exchange or involuntarily delists its securities, or the institution voluntarily delists its securities, pursuant to the rules of the relevant national securities exchange;

~~(vi)~~ For a State or agency action under paragraphs (c)(1)(~~iii~~iv), (c)(1)(v), or (d)(1) or (d)(5) of this section, not later than 10 days after the date on which the institution is notified by its State or accrediting agency of that action;

(vii) For the creditor events in paragraph (c)(xi), not later than 10 days after the date on which the institution is notified of the action by its creditor;

(viii) For the loan agreement/creditor events described provisions in paragraph (d)(2) of this section, not later than 10 days after the event occurs, with an update not later than 10 days after a loan violation occurs; the creditor waives the violation, or the creditor imposes sanctions or penalties, including sanctions or penalties imposed in exchange or as a result of granting the waiver; and

~~(vi)~~ For a State agency notice relating to terminating an institution's licensure or authorization under paragraph (d)(3) of this section, 10 days after the date on which the institution receives that notice; and

~~(viii)~~ For the non-title IV Federal educational assistance funds revenue provision in paragraph (c)(1)(vii) ~~(d)(4)~~ of this section, no later than 45 days after the end of the institution's fiscal year, as provided in § 668.28(c)(3); and

(x) For the loss of eligibility for another Federal educational assistance program, not later than 10 days following the action;

~~(ix)~~ For the discontinuation of academic programs provision in paragraph (d)(7), not later than 10 days after the discontinuation of programs in the institution's fiscal year affecting at least 25 percent of enrolled students;

(xiii) For a failure to meet any of the standards in paragraph (b) of this section, not later than 10 days after the institution ceases to meet the standard.

(2) The Secretary may take an administrative action under paragraph (i) of this section against an institution, or determine that the institution is not financially responsible, if it fails to provide timely notice to the Secretary as provided under paragraph (f)(1) of this section, or fails to respond, within the timeframe specified by the Secretary, to any determination made, or request for information, by the Secretary under paragraph (f)(3) of this section.

(3)

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(i) In its notice to the Secretary under this paragraph, or in its response to a preliminary determination by the Secretary that the institution is not financially responsible because of a triggering event under paragraph (c) or (d) of this section, in accordance with procedures established by the Secretary, the institution may -

(A) Demonstrate that the reported withdrawal of owner's equity under paragraph (c)(1)(ii)(B) of this section was used exclusively to meet tax liabilities of the institution or its owners for income derived from the institution;

(AB) Show that the creditor waived a violation of a loan agreement under paragraph (d)(2) of this section. However, if the creditor imposes additional constraints or requirements as a condition of waiving the violation, or imposes penalties or requirements under paragraph (d)(2)(ii) of this section, the institution must identify and describe those penalties, constraints, or requirements and demonstrate that complying with those actions will not adversely affect the institution's ability to meet its financial obligations;

(BC) Show that the triggering event has been resolved, or demonstrate that the institution has insurance that will cover all or part of the liabilities that arise under paragraph (c)(1)(i)(A) of this section; or

(CD) Explain or provide information about the conditions or circumstances that precipitated a triggering event under paragraph (c) or (d) of this section that demonstrates that the triggering event has not or will not have a material adverse effect on the institution.

(ii) The Secretary will consider the information provided by the institution in determining whether to issue a final determination that the institution is not financially responsible.

(g) Public institutions.

(1) The Secretary considers a domestic public institution to be financially responsible if the institution -

(i)

(A) Notifies the Secretary that it is designated as a public institution by the State, local, or municipal government entity, Tribal authority, or other government entity that has the legal authority to make that designation; and

(B) Provides a letter from an official of that State or other government entity confirming that the institution is a public institution and is backed by the full faith and credit of the State, local, or municipal government entity, Tribal authority, or other government entity; and

(ii) Is not subject to a condition of past performance under § 668.174.

(2) The Secretary considers a foreign public institution to be financially responsible if the institution -

(i)

(A) Notifies the Secretary that it is designated as a public institution by the country or other government entity that has the legal authority to make that designation; and

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(B) Provides documentation from an official of that country or other government entity confirming that the institution is a public institution and is backed by the full faith and credit of the country or other government entity; and

(ii) Is not subject to a condition of past performance under § 668.174.

(h) *Audit opinions and disclosures.* Even if an institution satisfies all of the general standards of financial responsibility under paragraph (b) of this section, the Secretary does not consider the institution to be financially responsible if in the institution's audited financial statements (i) include an opinion expressed by the auditor that was an adverse, qualified, or disclaimed opinion, or (ii) include the institution was required to include financial statements contain a disclosure in the notes to the financial statements that contains information there is substantial doubt about the institution's or entity's diminished liquidity, ability to continue operations as a going concern as required by accounting standards, or ability to continue as a going concern; unless the Secretary determines that a qualified or disclaimed opinion does not have a significant bearing on the institution's financial condition, or that the diminished liquidity, ability to continue operations, or ability to continue as a going concern substantial doubt about the institution's ability to continue as going concern operations has been alleviated. The Secretary may conclude that diminished liquidity, ability to continue operations, or ability to continue as a going concern has not been alleviated even if the auditor states that those concerns have been alleviated.

(i) Administrative actions. If the Secretary determines that an institution is not financially responsible under the standards and provisions of this section or under an alternative standard in § 668.175, or the institution does not submit its financial and compliance audits by the date and in the manner required under § 668.23, the Secretary may -

(1) Initiate an action under subpart G of this part to fine the institution, or limit, suspend, or terminate the institution's participation in the title IV, HEA programs;

(2) For an institution that is provisionally certified, take an action against the institution under the procedures established in § 668.13(d); or

(3) Deny the institution's application for certification or recertification to participate in the title IV, HEA programs.

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§ 668.174 Past performance.

(a) Past performance of an institution. An institution is not financially responsible if the institution -

(1) Has been limited, suspended, terminated, or entered into a settlement agreement to resolve a limitation, suspension, or termination action initiated by the Secretary or a guaranty agency, as defined in 34 CFR part 682, within the preceding five years;

(2) In either of its two most recent compliance audits had an audit finding, or in a report issued by the Secretary had a program review finding for its current fiscal year or either of its preceding two fiscal years had a program review finding, that resulted in the institution's being required to repay an amount greater than 5 percent of the funds that the institution received under the title IV, HEA programs during the year covered by that audit or program review;

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(3) Has been cited during the preceding five years for failure to submit in a timely fashion acceptable compliance and financial statement audits required under this part, or acceptable audit reports required under the individual title IV, HEA program regulations; or

(4) Has failed to resolve satisfactorily any compliance problems identified in audit or program review reports based upon a final decision of the Secretary issued pursuant to subpart G or H of this part.

(b) Past performance of persons or entities affiliated with an institution.

(2) The Secretary may determine that an institution is financially responsible, even if the institution is not otherwise financially responsible under [paragraph \(b\)\(1\)](#) of this section, if -

(i) The institution notifies the Secretary, within the time permitted and in the manner provided under 34 CFR 600.2136, that the person or entity referenced in [paragraph \(b\)\(1\)](#) of this section exercises substantial control over the institution; and

(c) Ownership interest.

(1) An ownership interest is ~~a share of the legal or beneficial ownership or control of, or a right to share in the proceeds of the operation of, an institution, an institution's parent corporation, a third-party servicer, or a third-party servicer's parent corporation. The term "ownership interest" includes, but is not limited to -~~

~~(i) An interest as tenant in common, joint tenant, or tenant by the entireties;~~

~~(ii) A partnership; and~~

~~(iii) An interest in a trust.~~

~~(2) The term "ownership interest" does not include any share of the ownership or control of, or any right to share in the proceeds of the operation of a profit-sharing plan, provided that all employees are covered by the plan, defined in 600.31(b).~~

§ 668.175 Alternative standards and requirements.

(a) General. An institution that is not financially responsible under the general standards and provisions in § 668.171, may begin or continue to participate in the title IV, HEA programs by qualifying under an alternate standard set forth in this section.

(b) Letter of credit or cash escrow surety alternative for new institutions. A new institution that is not financially responsible solely because the Secretary determines that its composite score is less than 1.5, qualifies as a financially responsible institution by submitting an irrevocable letter of credit that is acceptable and payable to the Secretary, or providing other surety described under paragraph (h)(2)(i) of this section, for an amount equal to at least one-half of the amount of title IV, HEA program funds that the Secretary determines the institution will receive during its initial year of participation. A new institution is an institution that seeks to participate for the first time in the title IV, HEA programs.

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(c) Financial protection alternative for participating institutions. A participating institution that is not financially responsible, either because it does not satisfy one or more of the standards of financial responsibility under § 668.171(b), (c), or (d), or because of an audit opinion or **going concern** disclosure **about the institution's liquidity, ability to continue operations, or ability to continue as a going concern** described under § 668.171(h), qualifies as a financially responsible institution by submitting an irrevocable letter of credit that is acceptable and payable to the Secretary, or providing other **financial protection surety** described under paragraph (h)(2)(i) of this section, for an amount determined by the Secretary that is not less than one-half of the title IV, HEA program funds received by the institution during its most recently completed fiscal year, except that this requirement does not apply to a public institution. **For purposes of a failure under § 668.171(b), the institution must also take reasonable steps to remedy the issue(s) that gave rise to the failure.**

(d) Zone alternative.

(1) A participating institution that is not financially responsible solely because the Secretary determines that its composite score under § 668.172 is less than 1.5 may participate in the title IV, HEA programs as a financially responsible institution for no more than three consecutive years, beginning with the year in which the Secretary determines that the institution qualifies under this alternative.

(i)

(A) An institution qualifies initially under this alternative if, based on the institution's audited financial statement for its most recently completed fiscal year, the Secretary determines that its composite score is in the range from 1.0 to 1.4; and

(B) An institution continues to qualify under this alternative if, based on the institution's audited financial statement for each of its subsequent two fiscal years, the Secretary determines that the institution's composite score is in the range from 1.0 to 1.4.

(ii) An institution that qualified under this alternative for three consecutive years, or for one of those years, may not seek to qualify again under this alternative until the year after the institution achieves a composite score of at least 1.5, as determined by the Secretary.

(2) Under the zone alternative, the Secretary -

(i) Requires the institution to make disbursements to eligible students and parents, and to otherwise comply with the provisions, under either the heightened cash monitoring or reimbursement payment method described in § 668.162;

(ii) Requires the institution to provide timely information regarding any of the following oversight and financial events -

(A) Any event that causes the institution, or related entity as defined in Accounting Standards Codification (ASC) 850, to realize any liability that was noted as a contingent liability in the institution's or related entity's most recent audited financial statement; or

(B) Any losses that are unusual in nature or infrequently occur, or both, as defined in accordance with Accounting Standards Update (ASU) No. 2015-01 and ASC 225;

(iii) May require the institution to submit its financial statement and compliance audits earlier than the time specified under § 668.23(a)(4); and

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(iv) May require the institution to provide information about its current operations and future plans.

(3) Under the zone alternative, the institution must -

(i) For any oversight or financial event described in paragraph (d)(2)(ii) of this section for which the institution is required to provide information, in accordance with procedures established by the Secretary, notify the Secretary no later than 10 days after that event occurs; and

(ii) As part of its compliance audit, require its auditor to express an opinion on the institution's compliance with the requirements under the zone alternative, including the institution's administration of the payment method under which the institution received and disbursed title IV, HEA program funds.

(4) If an institution fails to comply with the requirements under paragraph (d)(2) or (3) of this section, the Secretary may determine that the institution no longer qualifies under this alternative.

(e) [Reserved]

(f) Provisional certification alternative.

(1) The Secretary may permit an institution that is not financially responsible to participate in the title IV, HEA programs under a provisional certification for no more than three consecutive years if -

(i) The institution is not financially responsible because it does not satisfy the general standards under § 668.171(b), its recalculated composite score under § 668.171(e) is less than 1.0, it is subject to an action or event under § 668.171(c), or an action or event under paragraph (d) that has an adverse material effect on the institution as determined by the Secretary, or because of an audit opinion or going concern disclosure described in § 668.171(h); or

(ii) The institution is not financially responsible because of a condition of past performance, as provided under § 668.174(a), and the institution demonstrates to the Secretary that it has satisfied or resolved that condition; and

(2) Under this alternative, the institution must -

(i) Provide to the Secretary an irrevocable letter of credit that is acceptable and payable to the Secretary, or provide other financial protection described under paragraph (h) of this section, for an amount determined by the Secretary that is not less than 10 percent of the title IV, HEA program funds received by the institution during its most recently completed fiscal year, except that this requirement does not apply to a public institution that the Secretary determines is backed by the full faith and credit of the State;

(ii) Take reasonable steps to remedy the issue(s) that gave rise to its failure under § 668.171(b); Demonstrate that it was current on its debt payments and has met all of its financial obligations, as required under § 668.171(b)(3), for its two most recent fiscal years; and

(iii) Comply with the provisions under the zone alternative, as provided under paragraph (d)(2) and (3) of this section.

§ 668.176 Change in Ownership

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(a) Purpose. To continue participation in the title IV, HEA programs during and following a change in ownership, institutions must meet the financial responsibility requirements in this section.

(b) Materially complete application. To meet the requirements of a materially complete application as required in 34 CFR 600.20(g)(2)(iii) and (iv)-

(1) An institution undergoing a change of ownership and control as provided under 34 CFR 600.31 must submit audited financial statements of its two most recently completed fiscal years prior to the change in ownership, at the level of the change in ownership or the level of financial statements required by the Secretary, that are prepared and audited in accordance with the requirements of §668.23(d);-

(2) The institution must submit audited financial statements of the institution's new owner's two most recently completed fiscal years prior to the change in ownership that are prepared and audited in accordance with the requirements of §34 CFR 668.23 at the highest level of unfractured ownership or at the level required by the Secretary.

(i) If the institution's new owner does not have two years of acceptable audited financial statements, the institution must provide financial protection in the form of a letter of credit or cash to the Secretary in the amount of 25 percent of the title IV, HEA program funds received by the institution during its most recently completed fiscal year; or

(ii) If the institution's new owner only has one year of acceptable financial statements, the institution must provide financial protection in the form of a letter of credit or cash to the Secretary in the amount of 10 percent of the title IV, HEA program funds received by the institution during its most recently completed fiscal year.;

(3) The institution must—

(i) Meet the financial responsibility requirements. In general, the Secretary considers an institution to be financially responsible only if it –

(A) For a for-profit institution evaluated at the ownership level required by the Secretary-

(1) Has not had operating losses in either or both of its two latest fiscal years that in sum result in a decrease in tangible net worth in excess of 10 percent of the institution's tangible net worth at the beginning of the first year of the two-year period. The Secretary may calculate an operating loss for an institution by excluding: prior period adjustment and the cumulative effect of changes in accounting principle. For purposes of this section, the calculation of tangible net worth must exclude all related party accounts receivable/other assets and all assets defined as intangible in accordance with the composite score;

(2) Has, for its two most recent fiscal years, a positive tangible net worth. In applying this standard, a positive tangible net worth occurs when the institution's tangible assets exceed its liabilities. The calculation of tangible net worth excludes all related party accounts receivables/other assets and all assets classified as intangible in accordance with the composite score; ~~or~~ and

(3) Has a passing composite score and meets the other financial requirements of 34 CFR 668 subpart L for its most recently completed fiscal year;

(B) For a nonprofit institution evaluated at the ownership level required by the Secretary:

(1) Has, at the end of its two most recent fiscal years, positive net assets without donor restrictions. The Secretary will exclude all related party receivables/other assets from net assets without donor restrictions and all assets classified as intangibles in accordance with the composite score;

(2) Has not had an excess of net assets without donor restriction current fund expenditures over net assets without donor restriction current fund revenues over both of its two latest fiscal years that results in a decrease exceeding 10 percent in either the net assets without donor restrictions from the start to the end of the two-year period or the net assets without donor restriction in either one of the two years. The Secretary may exclude from net changes in fund balances for the operating loss calculation:- prior period adjustment and the cumulative effect of changes in accounting principle. In calculating the net assets without donor restriction, the Secretary will exclude all related party accounts receivables/other assets and all assets classified as intangible in accordance with the composite score; ~~or~~ and

(3) Has a passing composite score and meets the other financial requirements of 34 CFR 668 subpart L for its most recently completed fiscal year; or

(C) For a public institution, has its liabilities backed by the full faith and credit of a State, or by an equivalent governmental entity. ~~or~~

Notwithstanding the foregoing, the Secretary may determine that the institution is not financially responsible following a change in ownership if the amount of debt assumed to complete the change in ownership requires payments (either periodic or balloon) that are inconsistent with available cash to service those payments based on enrollments for the period prior to when the payment is or will be due.

(ii) For a for-profit or nonprofit institution that is not financially responsible under paragraph (b)(3)(i) of this section, provide financial protection in the form of a letter of credit or cash in an amount that is not less than 10 percent of the prior year title IV funding or an amount determined by the Secretary; and must follow the zone requirements of § 668.175(d).

(c) Terms of the extension. To meet the requirements for a temporary provisional Program Participation Agreement following a change in ownership, as described in 34 CFR 600.20(h)(3)(i)—

(1)(i) The institution provides the Secretary with—

(A) A “same day” balance sheet for a proprietary institution or a statement of financial position for a nonprofit institution that shows the financial position of the institution under its new owner, as of the day after the change in ownership, at the level required by the Secretary;

(B) The “same day” balance sheet or statement of financial position must be prepared in accordance with Generally Accepted Accounting Principles (GAAP) published by the Financial Accounting Standards Board and audited in accordance with Generally Accepted Government Auditing Standards (GAGAS) published by the U.S. General Accountability Accounting Office;

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(C) As part of the “same day” financial statement, the institution must include a disclosure that includes all related-party transactions and such details as would enable the Secretary to identify the related party. Such information may include, but is not limited to, the name, location, and description of the related entity, including the nature and amount of any transaction between the related party and the institution, financial or otherwise, regardless of when it occurred; and

(ii) Such financial statement must be a consolidated “same day” financial statement at the level of highest unfractured ownership or at a level determined by the Secretary for an ownership of less than 100 percent;

(2) The “same day” financial statement must demonstrate an acid test ratio of at least 1:1. The acid test ratio must be calculated by adding cash and cash equivalents to current accounts receivable and dividing the sum by total current liabilities. The calculation of the acid test ratio must exclude all related party receivables/other assets and all assets classified as intangibles in accordance with the composite score;-

(3) A proprietary institution’s submission must demonstrate a positive tangible net worth the day after the change in ownership. A positive tangible net worth occurs when the financial statements tangible assets exceed its liabilities. The calculation of tangible net worth must exclude all related party accounts receivables or other assets and all assets classified as intangible in accordance with the composite score;

(4) A nonprofit institution’s submission must have a positive net assets without donor restriction the day after the change in ownership. The calculation of net assets without donor restriction must exclude all related party accounts receivables/other assets and all assets classified as intangible in accordance with the composite score;

(5) If an institution fails to meet the standards of paragraphs (c)(2), (3), or (4) of this section, the institution must provide financial protection in the form of a letter of credit or cash to the Secretary in the amount of at least 25 percent of the title IV, HEA program funds received by the institution during its most recently completed fiscal year, or an amount determined by the Secretary, and must follow the zone requirements of § 668.175(d); and

(6) A public institution must have its liabilities backed by the full faith and credit of a State, or by an equivalent governmental entity, or must follow the requirements of this section for a nonprofit or proprietary institution.

§ 668.1767 Severability.

If any provision of this subpart or its application to any person, act, or practice is held invalid, the remainder of the subpart or the application of its provisions to any person, act, or practice will not be affected thereby.