Associated Technical College
Eligibility of Institutions to Participate in Title IV Programs and Other Issues

FINAL AUDIT REPORT

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Our mission is to promote the efficient and effective use of taxpayer dollars in support of American education

U.S. Department of Education
Office of Inspector General
Sacramento, California

NOTICE

Statements that financial and/or managerial practices need improvement or recommendations that costs questioned be refunded or unsupported costs be adequately supported, and recommendations for the better use of funds, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determinations on these matters will be made by the appropriate Education Department officials.

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Executive Summary

Associated Technical College (ATC) did not meet Federal requirements for participation in Title IV Student Financial Assistance Programs at two of its three institutions. Also, ATC did not comply with certain provisions of the Higher Education Act (HEA) and Federal regulations in its administration of the Federal Pell Grant Program.

- ATC's Los Angeles and San Diego campuses did not qualify as eligible proprietary institutions of higher education because revenues from Title IV programs exceeded 85 percent of campus revenues. Under the HEA, proprietary institutions must derive at least 15 percent of their revenues from non-Title IV sources to participate in Title IV programs. ATC improperly included institutional scholarships when determining its non-Title IV revenues. As a result, ATC concluded that all its campuses met the 85 percent requirement when, in fact, two of the three campuses had not met the requirement.

- ATC overstated its actual tuition costs when calculating student refunds. As a result, ATC understated the refunds due to the Pell Grant Program for students who dropped from the institutions.

- ATC lacked adequate record maintenance. Student files for 51 of 145 selected students were not made available at the time of our review. In addition, ATC could not readily provide us with supporting documentation on cash revenues for the Anaheim campus and receivables for all campuses. ATC's failure to provide this information indicates that it may not have the necessary administrative capability to participate in Title IV Programs.

We recommend that the Assistant Secretary for Postsecondary Education take emergency action to terminate participation of the Los Angeles and San Diego campuses in the Title IV programs. The Assistant Secretary should also require that ATC return the $8.6 million received by the two campuses after July 1, 1995, the date that the campuses became ineligible under the 85 percent rule. In addition, ATC should identify and return any additional refund amounts due for students who dropped from the Anaheim campus during the period July 1, 1995 to present. The report also includes procedural recommendations for the Anaheim institution.

In its comments on the draft report, ATC did not agree with the facts and recommendations presented. However, it did express willingness to improving its record keeping system. The full text of ATC's response is included as an Attachment to this report.

Audit Results

We concluded that ATC administered the Pell Grant Program in accordance with the Higher Education Act (HEA) provisions covering use of professional judgement in determining award amounts. However, ATC did not comply with HEA provisions and Federal regulations covering institutional eligibility and refunds. We also found that ATC lacked adequate record maintenance.

Two of Three Freestanding Campuses Failed to Meet the 85 Percent Rule

As of July 1, 1995, ATC's Los Angeles and San Diego campuses did not qualify as eligible proprietary institutions of higher education because revenues from Title IV programs exceeded 85 percent of campus revenues. The HEA, Section 481(b) states *"the term 'proprietary institution of higher education' means a school* . . .(6) *which has at least 15 percent of its revenues from sources that are not derived from [HEA, Title IV] funds* . . . ." This institutional eligibility requirement is codified in Title 34 of the Code of Federal Regulations (CFR), Section 600.5 (a)(8). The regulations also provide the formula for assessing whether an institution has satisfied the requirement and specify that amounts used in the formula must be received by the institution during its fiscal year. Specifically, 34 CFR Section 600.5(d)(2)(i), states that *"...the title IV, HEA program funds included in the numerator and the revenue included in the denominator are the amount of title IV, HEA program funds and revenues received by the institution during the institution's last complete fiscal year."*

ATC's Los Angeles and San Diego campuses cash receipts from non-Title IV sources were less than 15 percent of campus revenues. The following table summarizes our analysis of revenues for ATC's three campuses. The amounts shown are for ATC's fiscal years ending December 31.

Table 1. OIG's Computation of ATC's Percentage of Non-Title IV Funds. *Two of ATC's campuses did not have non-Title IV revenues that meet the 15 percent minimum.*

Campus	Los Angeles			San Diego			Anaheim		
	1994	1995	1996	1994	1995	1996	1994	1995	1996
Title IV Funds	$5,427,454	$4,520,606	$2,244,062	$743,349	$544,202	$479,284	$922,175	$788,560	$507,519
Cash	445,284	404,137	202,155	100,626	84,035	50,495	419,606	289,001	250,939
Total Revenue	$5,872,738	$4,924,743	$2,446,217	$843,975	$628,237	$529,779	$1,341,781	$1,077,561	$758,458
Non-Title IV Funds as a Percent of Total Revenue	**8%**	**8%**	**8%**	**12%**	**13%**	**10%**	**31%**	**27%**	**33%**

Table 1 shows that the non-Title IV revenues for the Los Angeles and San Diego campuses represented less than 15 percent of the total revenues. The 85 Percent Rule became enforceable on July 1, 1995. Therefore, the two campuses were ineligible to receive Title IV funds as of that date.

ATC provided the cash amounts shown in Table 1 and supporting documents related to the amount shown for the Anaheim campus for the year ended December 31, 1994. Our review of the supporting documents disclosed that ATC's bank accounts confirmed about $388,000 in cash deposits from non-Title IV sources during calendar year 1994. While this amount was less than the $419,606 of cash revenue shown in Table 1, the $388,000 was sufficient for the Anaheim campus to meet the 85 Percent Rule. The difference was primarily due to ATC's failure to provide support for certain cash receipt amounts.

ATC was unable to readily make available supporting documentation for Anaheim's cash receipts for calendar years 1995 and 1996. Therefore, we were unable to confirm that the Anaheim campus met the 85 Percent Rule in those two years. Audit tests to confirm cash receipts shown for the Los Angeles and San Diego campuses were not necessary. For those campuses, ATC showed cash amounts from non-Title IV sources that were below the 15 percent level required by the HEA.

ATC improperly included institutional scholarships when calculating its non-Title IV funds percentage. When ATC calculated its percentage of revenues from non-Title IV sources, it improperly included its conditional institutional scholarships in the calculation. ATC's institutional scholarships had no value under a cash-basis method of accounting and its institutional scholarships and loans artificially inflated institutional charges. The inclusion of the institutional scholarships gave the impression that all ATC campuses met the 85 Percent Rule, when, as noted in the previous section, two of the three campuses had not met the requirement.[1]

The following table shows the percentages that resulted from ATC's computations with the inclusion of institutional scholarships as a source of non-Title IV revenue:

[1] We also found that ATC used a composite percentage that it calculated by combining the revenue amounts for each campus. While ATC prepares financial statements that consolidate the financial information for the three campuses, it should have considered the campuses individually for assessing compliance with the 85 Percent Rule. The campuses receive Title IV funds under separate Office of Postsecondary Education (OPE) numbers and program participation agreements and submitted separate packages for recertification of their eligibility for Title IV funds.

Table 2. ATC's Computation of Percentage of Non-Title IV Funds. *The inclusion of the institutional scholarships gave the impression that all ATC campuses meet the 85 Percent Rule.*

Campus	Los Angeles			San Diego			Anaheim		
	1994	1995	1996	1994	1995	1996	1994	1995	1996
Title IV Funds[2]	$5,304,488	$4,825,697	$2,562,145	$976,839	$857,090	$535,507	$710,385	$726,414	$509,778
Cash	445,284	404,137	202,155	100,626	84,035	50,495	419,606	289,001	250,939
Scholarships	2,281,023	752,088	1,639,905	93,662	85,097	128,611	316,080	42,943	81,730
Total Revenue	$8,030,795	$5,981,922	$4,404,205	$1,171,127	$1,026,222	$714,613	$1,446,071	$1,058,358	$842,447
Other Revenue as a Percent of Total Revenue	**34%**	**19%**	**42%**	**17%**	**16%**	**25%**	**51%**	**31%**	**39%**

When the regulations covering the 85 Percent Rule were issued on April 29, 1994, the Department stated its position on including institutional scholarships and institutional loans as revenue. In the *Analysis of Comments and Changes* section of the Final Rule, the Secretary stated that:

> *"An institution is not prohibited from including institutional charges that were **paid*** [emphasis added] *by institutional scholarships and institutional loans as revenue . . . provided that the scholarships and loans are valid and not just a part of a scheme to artificially inflate an institution's tuition and fee charges. For this purpose, the Secretary does not consider institutional loans to be real unless such loans are routinely repaid by the student borrowers. The Secretary does not consider institutional scholarships to be valid if every student receives such a scholarship so that no student ever pays the claimed tuition and fee charges . . . In this connection, the Secretary will scrutinize institutions that raise their tuition and fee charges to avoid the 85 percent rule but can show no actual payment of those additional charges, or payment through 'artificial' institutional scholarships and loans."*

Also, the *Analysis of Comments and Changes* section of the Final Rule clarifies that revenues must be reported on a **cash-basis** method in the numerator and denominator of the formula for calculating the non-Title IV funds percentage of total revenues:

> *"... since institutions must report and account for title IV, HEA program funds on a cash basis, the institution must also account for revenue in the denominator on a cash basis. Under a cash basis of accounting, the institution reports revenues on the date that the revenues are actually received."*

ATC awards students who are eligible to receive Title IV funds with an institutional scholarship, an institutional loan, or both. During the enrollment process, ATC prepares a Retail Installment Contract that shows the school's tuition charges and method of payment. Typically, the method of payment

[2] ATC's controller could not reconcile the differences between Title IV fund amounts shown in Tables 1 and 2. Table 1 uses Title IV fund amounts that we extracted from the school's Federal Cash Transactions Reports (SF-272s). According to ATC's controller, the amounts used in Table 2 represent deposits of Title IV funds shown on the institution's bank statements.

includes either an institutional loan or scholarship. The amount of the loan or scholarship is usually the difference between the listed institutional charges and the amount of funds that the student may receive from Title IV programs, and minimal cash payments anticipated from the student.

If the student is awarded an institutional loan, he/she signs a promissory note for the amount of the loan.[3] Institutional scholarship documents are also prepared during the enrollment process, i.e. students must complete their educational program as a condition to receive a scholarship. At the time the institutional loans and scholarships are awarded, neither the loan nor the scholarship is recorded on the student's account.

When the student completes his/her educational program, ATC records a credit (tuition reversal) in the students account for the scholarship amount. If the student has an institutional loan, ATC marks on the promissory note that the loan was paid with the scholarship. If the student withdraws prior to completing their educational program, the scholarship is "forfeited" and the student is left with a balance due on his/her account.[4]

ATC did not have an external source for loan and scholarship funds nor did it maintain its own funds in a separate account for loan or scholarship purposes. Amounts collected on its institutional loans were included in cash amounts shown in Tables 1 and 2.

The institutional scholarships should not have been included as non-Title IV Revenue in the 85 Percent Rule calculation.

- ATC's institutional scholarships have no value under a cash-basis method of accounting. ATC students who are awarded scholarships do not receive credit in their student accounts until after completion of their educational programs. The credit is applied by reversing the tuition charges by the amount of the scholarship. This tuition reversal involves no receipt, disbursement or transfer of funds between ATC's cash accounts. In fact, since ATC maintains its accounting records on a cash basis, no entry is made in ATC's accounting books for the tuition reversal recorded in the student account. In cash-basis accounting, a transaction is not recorded into the account books until cash is received or paid.[5] Therefore, no revenue is "received" when ATC makes a tuition reversal.

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[3] The loan terms state that repayment of the loan shall begin 30 days from the date that the student completes or withdraws from his/her educational program. Payments will be made in monthly installments of no less than $50 and an interest rate will be charged at the rate of 10 percent per annum on the unpaid balance. Interest charges will start upon the student's completion or withdrawal from his/her program. The promissory note states that information concerning the amount of this loan and its repayment will be reported to a national credit bureau if payments fall more than 120 days past due.

[4] For students who have withdrawn, the school must apply the appropriate refund policy to determine whether a refund is due to the student or Title IV program. Students may not have a balance owed on their student account after application of the refund amount.

[5] Horngren, Charles T. and Walter T. Harrison, Jr., ed. 1989. *Accounting*. Englewood Cliffs: Prentice Hall.

- # Almost all ATC's students who are eligible to receive Title IV funds are awarded an institutional scholarship, an institutional loan, or both. We found that ATC awarded scholarships and/or loans to 99.7 percent of Title IV students attending the Los Angeles campus and 93 percent of Title IV students attending the San Diego campus.[6]

- # ATC appears to expend little effort on collecting outstanding student account balances. According to an ATC school official, a letter is sent to students who have left the school without completing their educational programs.[7] The only evidence that ATC could provide of this process were copies of the form letters sent to students. ATC had no written procedures covering its collection process.

  While the form letters mention collection agencies, a school official informed us that the school does not use a collection agency to assist in collection of the loans. ATC makes no effort to locate students who have moved without leaving a forwarding address. The school official responsible for the collection process stated that collecting on loans was a low priority. Our review of student accounts found that 81 percent of San Diego students and 87 percent of Los Angeles students who had outstanding balances at the time they completed or dropped had not made subsequent payments on their accounts.[8]

Based on the above findings, we concluded that ATC's institutional scholarships had no value under a cash-basis method of accounting and the scholarships and loans had been used to artificially inflate institutional charges. Therefore, ATC should not have included scholarship amounts in its 85 Percent Rule calculations.

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[6] These percentages are based on a review of a statistical sample of students for the Los Angeles campus and all students for the San Diego campus who received Title IV Pell funds during the calendar year 1996. The 93 percent for the San Diego campus is comprised of the 91 percent of students whose Retail Installment Contracts show an institutional loan and the 2 percent of students whose Student Tuition Statements show an institutional scholarship covering a portion of tuition charges. The 99.7 percent for the Los Angeles campus is comprised of 49.2 percent institutional loans and 50.5 percent institutional scholarships, respectively. Details on the sampling methodology are provided in the "Purpose and Methodology" section of this report.

[7] The letter encourages the student to return to the school and also informs the students that the balance owed on their student account will be due if the student does not return. We were told that if the student does not respond, a second letter is sent within 30 to 60 day. Additional letters are sent about every 60 days.

[8] A total of 161 San Diego students and 158 Los Angeles students included in our review had outstanding balances due at the time they completed or dropped from their course. These students owed $100,166 and $186,079, respectively. As of February 1998, ATC's student accounts showed cash receipts applied toward these balances for 31 of the San Diego students and 20 of the Los Angeles students. The cash receipts totaled $5,764 and $2,693, respectively. Details on the sampling methodology are provided in the "Purpose and Methodology" section of this report.

Recommendations

We recommend that the Assistant Secretary for Postsecondary Education initiate emergency action to terminate the participation of ATC's Los Angeles and San Diego campuses in Title IV programs. Also, the Assistant Secretary should require that ATC:

- Return the Title IV funds received by the Los Angeles and San Diego campuses after July 1, 1995. During the period July 1, 1995 through February 1998, the Los Angeles and San Diego campuses received $7.0 million and $1.6 million in Title IV funds, respectively.

- Provide documentation to support non-Title IV cash revenue amounts used in the 85 Percent Rule calculations for the Anaheim campus for periods after December 31, 1994.

- Exclude its institutional scholarships and any other non-cash credits to the student accounts from its 85 Percent Rule calculations.

ATC Comments

ATC disagreed with our conclusion that its institutional scholarships had no value under the cash-basis method of accounting. ATC stated that our conclusion was based upon a narrow interpretation of "cash-basis" which was both arbitrary and restrictive. ATC provided citations from accounting literature from which it concluded that "cash basis" refers to the time when transactions are recognized as income or expense rather than defining the means of payment or type of income. ATC asserted that its method for recording institutional scholarships using a book entry rather than a physical exchange of cash has no bearing on the issue of whether those scholarships have any value. In addition, it stated that the funds for the scholarship program come from ATC schools' parent company and are recognized as income by each free-standing campus.

OIG Response

The accounting literature cited by ATC supports rather than disputes our conclusion that their institutional scholarships should not be counted as cash revenue. ATC provided the following quote from an accounting textbook: "*Accounting for revenues on a cash basis means that . . . no record of revenue is made in the accounts until cash is received.*" This statement is consistent with the accounting textbook citations used in the report. That is, cash basis accounting recognizes revenue at the point cash is received.[9]

The Financial Accounting Standards Board (FASB) provides a definition of revenue in its Statement of Financial Accounting Concepts No. 6. The FASB defines revenues as "*inflows or other enhancements of assets of an entity or settlements of its liabilities (or combination of both) from delivering or producing goods, rendering services or other activities that constitute the entities ongoing major or central operations.*" The FASB Statement also states that "*Revenues represent actual or expected cash inflows (or the equivalent) that have occurred or will eventuate as a result*

[9] In contrast, the accrual basis of accounting recognizes revenue when sales are made or services are performed, regardless of when cash is received.

of the entity's ongoing major or central operations."[10] ATC's awarding of scholarships did not provide inflows of cash. In fact, when ATC recorded a scholarship credit (tuition reversal) in student accounts, the transaction reduced rather than increased its expected cash inflows (student balances due). Neither did ATC receive property or services from the student when the scholarship was awarded to the student. Our conclusion that no value was received by the institution is further supported by the facts that ATC did not report the scholarship amounts as revenue to the Internal Revenue Service on its 1995 and 1996 tax forms and did not record the scholarship transactions in its accounting records.

The effect of the scholarship program was a reduction in tuition revenue. The American Institute of Certified Public Accountants (AICPA) has issued an Industry Audit Guide for Audits of Colleges and Universities that are not-for-profit organizations. According to the AICPA audit guide, institutional scholarships and fellowships are expenditures for the college or university issuing them.
ATC's statement that "funds for the scholarship program come from the ATC schools' parent company" is unsupported. Our review found no evidence that Diversified Education Company transferred funds to the three institutions for scholarships. Even if such transfers occurred, the transfers of cash between a parent company and its subsidiaries would not meet the definition of revenue.

[10] FASB's Statement of Financial Accounting Standards No. 95 defines "cash equivalents" as short-term, highly liquid investments that are both readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

Use of Institutional Scholarships and Loans Resulted in Understated Refunds

As mentioned in the prior section, we concluded that ATC's institutional scholarships and loans had been used to artificially inflate institutional charges. As a result, the actual amount of tuition used in refund calculations was overstated and Pell refunds due to the Department were understated.

When students drop from school, an institution must refund any amount paid for tuition that is allocable to the uncompleted portion of the enrollment period. Title 34 CFR, Section 668.22(b) requires that an institution have a fair and equitable refund policy. The refund should be at least the largest amount under applicable state law, specific refund requirements established by the school's accrediting agency, or pro rata refund calculated.

As shown by the following formula, the tuition charge is a key factor in determining the refund amount. (The formulas were simplified to highlight the role of the tuition charge in calculating refunds.)

$$\frac{\textit{Units Completed}}{\textit{Units in Enrolled Period}} \quad X \quad \textit{Tuition Charge} = \textit{Tuition Earned}$$

$$\textit{Tuition Paid} - \textit{Tuition Earned} = \textit{Refund Amount (or Balance Due From Student)}$$

ATC understated refund amounts due to the Pell Grant Program when it included in its tuition charges, the amounts covered by contingent scholarships or institutional loans. The institutional scholarship and loan amounts should not be considered part of the tuition cost.

As part of our audit, we reviewed refund calculations for 65 students who enrolled and withdrew during the period July 1, 1995 through June 30, 1997.[11] ATC understated the refund amounts for 52 of the 65 students as a result of using an inflated tuition charge. The refunds for these 52 students were understated by $21,041.

[11] We selected a random sample of 115 students from the 1,150 students who withdrew from ATC during Pell award years 1995-96 and 1996-97. At the time we reviewed the refund calculations, ATC was able to provide us with student files for only 74 of the 115 students. Of the 74 students, 65 students received Student Financial Aid funds. Subsequent to completion of our review of refund calculations, ATC located 28 of the previously unlocated files.

Recommendations

The Assistant Secretary for Postsecondary Education should require ATC:

- Revise its procedures to ensure that actual school tuition (exclusive of institutional scholarships and loans) are used in refund calculations.

- Recalculate the refunds due for Anaheim campus students who dropped during the period July 1, 1995 to present using the revised procedures and return any additional amounts due to the Pell Grant program. We have not recommended that refunds be recalculated for the Los Angeles and San Diego campuses since the entire amount that these campuses received is recommended for recovery under a previous finding in this report.

ATC's Comments

ATC stated that their institutional loans are valid instruments of indebtedness and their institutional scholarships are valid and legitimate and were appropriately applied to the cost of tuition. It claimed that the Certified Public Accountant firm which certifies Diversified's financial statements recognized the validity of the loans. ATC also stated that it makes appropriate efforts to collect on every loan and that no law or regulations required a particular level of collections for loans.

OIG Response

ATC's comments did not change our conclusion. As we reported in the previous finding, the Department does not consider institutional scholarships to be valid if every student receives such a scholarship. The Department does not consider institutional loans to be real unless such loans are routinely repaid by the student borrower. Our review found that ATC awarded either institutional scholarships or loans to 99.7 percent of Title IV students attending the Los Angeles campus and 93 percent of Title IV students attending the San Diego campus. Our review of student accounts found that 81 percent of San Diego students and 87 percent of Los Angeles students who had outstanding balances at the time they completed or dropped had not made subsequent payments on their accounts.

ATC provided no additional documentation to support its statement that "it makes appropriate efforts to collect on each and every loan." We agree that there is no law or regulation mandating a particular level of collections. However, the Department has set a collection standard for the loans to be considered real -- that is, the loans are routinely repaid by the student borrowers.

ATC Lacked Adequate Record Maintenance

ATC did not maintain its student and financial records in an organized and readily available manner. We were unable to locate student files for 35 percent of the students selected for review in our audit. Also, ATC could not readily provide us with the necessary financial records to confirm cash amounts and receivables.

Federal regulations require that an institution maintain required records in a systematically organized manner and make its records readily available for review (34 CFR 668.24(d)(1) and (2)).

ATC's lack of adequate record maintenance can affect its ability to participate in Title IV Programs. Title 34 CFR Section 668.16 states that *"To begin and to continue to participate in any Title IV, HEA program, an institution shall demonstrate to the Secretary that the institution is capable of adequately administering that program...."* One standard of administrative capability is that the institution *"Establishes and maintains records required under this part and the individual Title IV, HEA program regulations."*

Student Files for 51 of 145 selected students were not made available at the time of our review. As part of our review of refund calculations and professional judgement actions, we selected random samples of students for the three ATC campuses. With the assistance of ATC's financial aid personnel, we attempted to locate the student files in the institution's filing system. The financial aid personnel were unable to locate files for 41 of the 115 students in our refund sample and 10 of 30 in our professional judgement sample, or about 35 percent of the student files. Subsequent to the completion of our refund and professional judgement reviews, ATC found 32 of the 51 previously unlocated files. At this time, ATC has not provided us with the remaining 19 student files.

Since ATC could not provide us with the files, we have no assurance that ATC maintained complete records for the 19 students and that Title IV funds were used appropriately. We were able to locate sufficient alternative documentation or information to provide us with a reasonable level of assurance that 12 of the 19 students were eligible to receive Pell Grant funds. ATC needs to implement the steps necessary to establish and maintain a reliable file management system.

Support for financial data was not readily available. ATC could not readily provide us with the necessary financial records to confirm cash amounts and receivables.

- ATC did not provide us with supporting documentation for non-Title IV cash revenues for the Anaheim campus for the years ending December 31, 1995 and 1996. The school's controller stated that ATC does not currently prepare reports on cash revenues and a search of ATC records to provide support for the non-Title IV cash receipts would take months.

- ATC could not readily provide us with a current list of its tuition receivables and student loan receivables. ATC reported tuition and student notes receivables of $3 million in its financial statements for fiscal year ended December 31, 1996. According to the controller, a receivables list is only prepared at the end of each fiscal year. At that time, the controller reviews each student account with a balance due to ascertain the amount to be used in preparing the financial statements. Our analysis of ATC's student account ledgers identified that, as of December 31, 1996, student balances due totaling over $24 million. The difference is primarily explained by ATC's practice of maintaining student ledger accounts on its file that cover about a 10-year period and not formally "writing off" outstanding balances without payment activity.

- ATC's student account ledgers were of limited use because non-cash transactions were coded as cash transactions and cash payments received from students could not be readily traced to specific bank deposits. We also found that the computerized database used to maintain the student account ledgers contained transactions with invalid or missing student social security numbers. The social security numbers are needed to link transactions, such as cash payments, to individual student accounts.

The availability of documentation on cash revenues and receivables impacted our ability to determine the proportion of receivables collected each year and assess the validity of ATC's collection activities. Also, the availability of supporting documentation impacted our ability to confirm the Anaheim campus' compliance with the 85 Percent Rule in fiscal years ended December 31, 1995 and 1996.

Recommendations

The Assistant Secretary for Postsecondary Education should require ATC:

- Implement the steps necessary to establish and maintain a reliable file management system.

- Revise its record keeping system to ensure that supporting documentation for cash revenue and receivable amounts can be located within a reasonable time frame.

ATC's Comments

ATC agreed that the auditors were unable to locate student files in its storage cabinets, but stated that its employees were able to subsequently locate the student files for them. ATC claimed that ATC's ability to provide the requested information in a timely manner was impacted by the volume and type of financial information requested by the auditors and that only one employee was available to compile the information. ATC also stated that no law or regulation exists that dictates the specific method of producing financial data. However, ATC stated it would review the report's recommendations to consider whether systems changes are warranted and feasible.

OIG Response

We are encouraged by ATC's comment regarding plans to explore improvements in its record keeping systems. However, overall ATC's comments did not change our conclusion. The regulations state that an institution must maintain required records in a systematically organized manner and make its records readily available for review.

Other Matters

During our fieldwork at ATC, we reviewed the institution's supporting data for student placement rates. The California State law requires that 70 percent or more of the students who completed the course within a specified period shall have obtained employment. The employment must start within six months after completing the course. The occupations or job titles related to their employment must be related to the employment goal of the course. If an institution fails to meet this standard, state approval to operate can be revoked.

ATC did not have reliable support for the claimed placement rate of 72 percent for the Anaheim campus for fiscal year 1995. We found that students were counted as successfully placed when the student was not placed at all. We did not review supporting documentation for the Anaheim campus placement rate for fiscal year 1996 and the placement rates for the other two campuses for fiscal years 1995 and 1996 because the claimed rates were below the required 70 percent. We notified the State of California, Bureau for Private Postsecondary and Vocational Education of ATC's noncompliance with the State statute.

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As part of our fieldwork, we met with a representative of the Certified Public Accountant (CPA) firm that reviewed ATC's financial statements for fiscal years ended December 31, 1995 and 1996. Our purpose was to obtain information on the extent of the CPA firm's review of amounts included in ATC's 85 Percent Rule calculation and its basis for concluding that the calculation was properly performed by the institution.

The CPA firm's representative explained that he performed the 85 Percent Rule calculation based on information distributed by a consultant of the California Association of Private Postsecondary Schools. The information consisted of an excerpt from an interpretation of the Analysis of Comments and Changes section of the Final rule. The excerpt did not cover the portion of the Analysis of Comments and Changes section which clarified that the revenue amounts used in the 85 Percent Rule calculation must be on a "cash basis of accounting."

Background

ATC was founded in 1967 and became a division of Diversified Education Company on January 1, 1975. ATC's institutions are accredited by the Accrediting Commission of Career Schools and Colleges of Technology. Vocational programs offered include medical assistance, microcomputer technology, and telecommunications.

ATC operates three freestanding, proprietary institutions located in Los Angeles, Anaheim and San Diego, California. Each campus receives Title IV funds under separate Office of Postsecondary Education (OPE) numbers and program participation agreements. The campuses submitted separate packages for recertification of their eligibility for Title IV funds. A consolidated financial statement covering the three ATC campuses is prepared under the corporation name of Diversified Education Company, Inc.

During the period July 1, 1995 through February 23, 1998, ATC's three campuses received about $9.5 million Pell Grant Program funds and about $500,000 in Supplemental Educational Opportunity Grant Program funds. ATC's campuses receive these funds under the reimbursement method. ATC institutions lost their eligibility to participate in Title IV student loan programs.

Purpose and Methodology

The objective of our audit was to determine whether ATC administered the Pell Grant Program in accordance with provisions of the Higher Education Act and Federal regulations covering institutional eligibility and refunds. We also reviewed the institutions' use of professional judgement in determining award amounts.

To accomplish our objective, we reviewed ATC's student files, state licensing and accreditation documents and ED records. We reviewed ATC's corporate financial statements and the most recent SFA audit reports prepared by its Certified Public Accountant. We also conducted interviews with ATC officials and staff.

To assess ATC's compliance with refund requirements, we selected a random sample of 115 students from an ATC provided list of 1,150 students who dropped from its three campuses during Pell award years 1995-96 and 1996-97. At the time we reviewed the refund calculations, ATC was able to provide us with student files for only 74 of the 115 students. Of the 74 students, 65 students received Student Financial Aid funds. We reviewed refund calculations for the 65 students.

To assess the institutions' use of professional judgement, we selected a random sample of 30 students from a universe of 531 recipients identified from the Pell Grant Recipient and Financial Management System for Pell award years 1995-96 and 1996-97. The institution had used professional judgement to determine the amount of the Pell Grant award for the 531 students. At the time we reviewed the use of professional judgement, ATC was able to provide us with student files for only 25 of the 30 students. We reviewed the institution's use of professional judgement for the 25 students.

We also selected a random sample of 306 students from the 1,193 students at the Los Angeles campus who received Pell Grant funds during calendar 1996. This sample was used to determine the percentage of students who were offered institutional scholarships and institutional loans at the time of enrollment. To determine this percentage for the San Diego students, we reviewed records for all students who received Pell Grant funds during the period. The records for these 306 Los Angeles students and the 254 San Diego students were also used to determine the percentage of outstanding student balances that ATC collected.

To achieve our audit objective, we relied on computer-generated data obtained from the Postsecondary Education Participants System (PEPS) and the Pell Grant Recipient and Financial Management System. This data was used for background information purposes and to identify the universe of Pell Grant recipients used to randomly select our student samples. We performed an analyses of and used information extracted from ATC's student account ledgers which are maintained on a computerized database. As noted in the Audit Results section of this report, the database was of limited use because transaction codes were not used consistently and transactions could not be readily traced to supporting documentation. Also, the database contained transactions that could not be linked to a particular student. When student account ledger information was used in deriving an audit conclusion, we confirmed the information with other sources, such as institutional bank statements and physical student records.

We issued SFA Action Memorandum No. 98-02 on November 17, 1997 to alert OPE that two of ATC's three campuses failed to meet the 85 Percent Rule.

Our audit covered the period July 1, 1995 through June 30, 1997. We performed fieldwork at ATC's main campus from July 28, 1997 through February 12, 1998. Additional work was completed in the Long Beach office through March 12, 1998. Our audit was performed in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.

Statement on Management Controls

As part of the review, we assessed ATC's management control structure, as well as its policies, procedures, and practices applicable to the scope of the audit. The purpose of our review was to assess the level of control risk for determining the nature, extent, and timing of our substantive tests. For the purpose of this report, we assessed and classified the significant management controls into the following categories:

--Institutional Eligibility
--Cash Management
--Student Eligibility
--Award Calculations
--Refunds

Because of inherent limitations, a study and evaluation made for the limited purposes described above would not necessarily disclose all material weaknesses in the control structure. However, our assessment disclosed weaknesses specifically related to the areas of institutional eligibility, refunds and record keeping. These weaknesses are discussed in the Audit Results section of this report.

Attachment

Associated Technical College's Response to the Report

OIG AUDIT TEAM

Audit Staff:

Mona Samuels-Sego, Auditor-In-Charge, MBA, CFE, CGFM
Joel Schoen, CGFM
Joseph Tong
Philip Guzzo
Thomas Roznowski, CGFM
Gloria Pilotti, Regional Inspector General, CPA, CGFM

Information Technology Staff:

Gregory Hayenga, CPA, CISA
Gary Forbort

Advice & Assistance Staff:

Patrick Howard, Director
Lee Greear

Report Distribution List
Audit Control No. A0970015

Auditee

Mr. Sam Romano, President Associated Technical College 1670 Wilshire Boulevard Los Angeles CA 90017	1

Action Official

Mr. David Longanecker, Assistant Secretary Office of Postsecondary Education U.S. Department of Education Regional Office Building, Room 4082 7th and D Streets, S.W. Washington DC 20202	4

Other ED Offices

Deputy Assistant Secretary for Student Financial Assistance	1
Director, Institutional Participation and Oversight Service	1
Director, Accounting and Financial Management Service	1
Office of Public Affairs	1
Area Case Director, San Francisco Team	1

Other

Director, California State Bureau for Private Postsecondary and Vocational Education	1
Director, Accrediting Commission of Career Schools and Colleges	1

Office of Inspector General

Acting Inspector General	1
Acting Deputy Inspector General	1
Assistant Inspector General for Investigations	1
Acting Assistant Inspector General for Audit	1
Assistant Inspector General for Operations, Eastern Area	1
Assistant Inspector General for Operations, Western Area	1
Director, Policy, Analysis and Management Services	1
Director, Advisory and Assistance Staff for Student Financial Assistance	1
Regional Inspectors General for Audit	1 each

U.S. DEPARTMENT OF EDUCATION

Office of Inspector General
801 I Street, Suite 219
Sacramento, CA 95814

MEMORANDUM

DATE: September 9, 1998

TO: Mr. David A. Longanecker
Assistant Secretary
Office Postsecondary Education

FROM: Regional Inspector General for Audit
Region IX

SUBJECT: FINAL AUDIT REPORT
"Associated Technical College Eligibility of Institutions To Participate in Title IV Programs and Other Issues."
ED Audit Control No. A0970015

Attached is our subject audit report presenting our findings and recommendations resulting from our audit of Associated Technical College, Los Angeles, California.

In accordance with the Department's Audit Resolution Directive, you have been designated as the action official responsible for the resolution of the findings and recommendations in this report.

If you have any questions or wish to discuss the contents of this report, please contact me at (916) 498-6622. Please refer to the above audit control number in all correspondence relating to this report.

GLORIA PILOTTI
Regional Inspector General
for Audit

Attachment

U.S. DEPARTMENT OF EDUCATION

Office of Inspector General
801 I Street, Suite 219
Sacramento, CA 95814

September 9, 1997

Mr. Thomas Fischetti, Director
Accrediting Commission of Career Schools and Colleges
2101 Wilson Boulevard Suite 302
Arlington, VA 22201

Dear Mr. Fischetti:

NOTICE OF FINAL INSPECTOR GENERAL AUDIT REPORT

Re: "Associated Technical College Eligibility of Institutions To Participate in Title IV Programs and Other Issues." -- ACN: A0970015
Issued: September 3, 1998

Enclosed is a copy of the above U.S. Department of Education Office of Inspector General final audit report. We are furnishing this report because it may contain information of interest to you.

If you have any questions concerning the enclosed audit report, please contact me on (916) 498-6622. Thank you for your interest in this matter.

Sincerely,

GLORIA PILOTTI
Regional Inspector General
for Audit

Enclosure

cc: Jeanne Van Vlandren, Director, Institutional
Participation and Oversight Service

U.S. DEPARTMENT OF EDUCATION

Office of Inspector General
801 I Street, Suite 219
Sacramento, CA 95814

ED Audit Control No. A0970015
September 9, 1998

Mr. Sam Romano, President
Associated Technical College
1670 Wilshire Boulevard
Los Angeles, CA 90017

Dear Mr. Romano,

Enclosed is our report entitled "Associated Technical College Eligibility of Institutions To Participate in Title IV Programs and Other Issues." The report incorporates the comments you provided in the response to the draft audit report. If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Education Department official, who will consider them before taking final Department action on this audit:

Mr. David A. Longanecker
Assistant Secretary
Office of Postsecondary Education
Regional Office Building
7th and D Streets, S.W., Room 4082
Washington, D.C. 20202

Office of Management and Budget Circular A-50 Directs Federal agencies to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within 30 days would be greatly appreciated.

In accordance with the Freedom of Information Act (Public Law 90-23), reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

Please refer to the above audit control number in all correspondence relating to this report.

Sincerely,

GLORIA PILOTTI
Regional Inspector General
for Audit

Diversified Education Company
1670 Wilshire Boulevard, Los Angeles, California 90017
Telephone (213) 413-6808; Fax (213) 413-6938

June 25, 1998

Gloria Pilotti
Regional Inspector General for Audit
Region IX
801 I Street, Room 219
Sacramento, CA 95814

Dear Ms. Pilotti:

As discussed by phone with your staff, we are faxing a copy of our response to the Draft Audit Report. A hard copy is being sent by Federal Express.

We have reviewed the findings in the draft audit, Audit Control No. A0970015 dated May 13, 1998 and we do not concur with the findings. Our comments are enclosed.

Thank you for giving us the opportunity to respond, and for providing us with an additional two weeks for doing so during what is a very busy time for us.

Sincerely yours,

Robert B. Dick

ASSOCIATED TECHNICAL COLLEGES
Robert B. Dick
Controller

ASSOCIATED TECHNICAL COLLEGES
RESPONSE TO DRAFT AUDIT REPORT
ED Audit Control No. A0970015

This response of Associated Technical Colleges (ATC), composed of independently approved campuses in Los Angeles, Anaheim and San Diego, California, limits the response to the Draft Audit Report to the "Accuracy, completeness or clarity" of that Report, as requested in the memorandum from the O.I.G. Regional Inspector General for Audit, Region IX, dated May 13, 1998. Associated Technical Colleges reserves the right to provide additional information, exhibits, arguments and discussion in response to the Final Audit Report at the appropriate time.

The Draft Audit Report contains three major findings:

ATC Los Angeles and San Diego failed to meet the requirements of the 85/15 rule on the basis of the conclusion in the Draft Audit Report that ATC inappropriately included institutional scholarships in calculating the percentage of revenues derived from other than Title IV sources.

ATC Anaheim understated refunds to the Federal Pell Grant program on the basis of the conclusion in the Draft Audit Report that ATC's institutional loans and scholarships artificially inflated institutional charges and therefore should not have been included in the cost of tuition when calculating refunds.

That various record keeping procedures of ATC were not adequate and need improvement.

ATC's response to the aforementioned findings may overlap and responses relating to any particular finding should be taken as applicable to all findings.

Institutional Scholarships

The assertion in the Draft Audit Report that ATC's institutional scholarships have no value under a cash-basis method of accounting is incorrect. The Audit Report based this conclusion upon a narrow interpretation of "cash-basis" which is both arbitrary and restrictive. More applicable is the definition of cash basis accounting given by Carson & Carlson in *College Accounting,* South Western Publishing Company, in which the authors say, "Accounting for revenues on a cash basis means that. . .no record of revenue is made in the accounts until cash is received." Further, "Any property or service that is accepted in place of cash *(emphasis added)* is treated as revenue." In *The Accountant's Handbook* by Seidler & Carmichael, John Wiley & Sons, page 9-50, the authors discuss notes to be added to audited financial statements when the books are kept on a cash basis.

> As described in Note X, the Company's policy is to prepare its financial statements on the basis of cash receipts and disbursements; consequently, certain revenue and the related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred.

Clearly, "Cash Basis" refers to the time when transactions are recognized as income or expense rather than defining the means of payment or type of income. The fact that ATC Los Angeles and ATC San Diego record institutional scholarships via a book entry rather than by a physical exchange of cash has no bearing on the issue of whether those scholarships have any value under a cash basis method of accounting. ATC appropriately recognizes income from scholarships when they are recorded, in accordance with the cash basis method of accounting as required by the 85/15 rule.

Furthermore, as ATC demonstrated, the funds for the scholarship program come from the ATC schools' parent company and are recognized as income by each free standing campus. In fact, the level of the scholarship is set by the parent company's Board of Directors and the scholarship is awarded to students only if they meet the scholarship criteria. Thus, the scholarships are valid and legitimate. The accounting treatment of the scholarship revenue is a matter of acceptable accounting practice and does not establish that scholarships provided by ATC have no value.

ATC has followed the Department of Education's regulations and the interpretation of those regulations as promulgated by the Secretary of Education. ATC's institutional scholarships meet established criteria. On that basis, the recommendations in the Draft Audit Report are not warranted and the finding should be dropped in the Final Report.

Calculation of Refunds

The Audit Report asserts that refunds have been improperly calculated based on the inclusion of scholarships and institutional loans in ATC's cost of tuition.

In the first place, as discussed above, ATC's scholarships are valid and legitimate and appropriately applied.

Second, the loans are valid instruments of indebtedness, which are recognized as valid loans by the CPA firm, which certifies Diversified's financial statements. These loans are evidenced by duly signed, legal instruments that meet the requirements of the State of California and the Federal Trade Commission. They have passed review by the State of California and the institution's accrediting commission. The institution makes appropriate efforts to collect on each and every loan. Thus, ATC has established that these loans are valid.

The report that the person responsible for collections stated that collection of loans was a low priority does not represent ATC's policy. In the first place, ATC disputes and denies that it gives collections a low priority. The fact that the level of collection is not as high as the OIG would like to see does not establish that collections are a low priority. All that collection history establishes is that ATC serves a lower income population which may not repay loans at as high a level as a higher income population might. The fact that ATC Anaheim collections are at a higher level than the Los Angeles campus, for instance, demonstrates that fact, since ATC Anaheim is located in a more affluent area and uniform collection policies are applied to all ATC loans. ATC requests that the name of the individual identified to whom this statement is attributed be included in the Final Report, as well as the context in which the alleged statement was made so that ATC can provide a fuller response to this assertion.

In addition, ATC has been unable to locate any laws or regulations requiring an institution to maintain a particular level of collections for loans to be considered valid. Thus ATC's collection level does not support the Draft Audit Report's assertions.

On the basis of the above, both ATC's scholarships and loans are valid under existing regulations and laws, and therefore, the recommendations in the

Draft Audit Report are not warranted. This finding should be dropped from the Final Report.

Adequate Record Maintenance

The Draft Audit Report asserts that ATC could not locate a number of files and that certain financial data was not readily available.

ATC believes that this finding is misleading. ATC agrees that the auditors themselves could not locate certain files in file cabinets where files were stored. However, when the auditors presented a list of the names of the files they could not find, ATC clerks were able to locate the files. ATC notes that ATC schools are operating under 'reimbursement' and under that system, files must be audited by an independent CPA before the institution can be reimbursed for Title IV payments. Files must be transported to the CPA's office for review. Therefore, student files are often out of the storage cabinets for legitimate reasons. ATC calls attention to the letter from Mr. Schoen which states that all but eight files had been found and indicates that the institution can stop looking for these missing files.

With respect to ATC's asserted inability to readily provide the OIG with financial records, ATC would like to point out that the auditors requested all cash transactions for an entire calendar year with each student payment and each deposit keyed to a print-out of the student ledger and that only one clerk was available to work on this request, and primarily during overtime hours in the evening and on weekends. The sheer volume of hundreds of payments which had to be keyed to entries on the student ledgers consumed hundreds of hours of time and would have done so regardless of the method of ATC used to file and record financial information.

ATC recognizes that the OIG may consider the method it uses to assemble accounts receivable data for year end financial reports to be cumbersome and time consuming. However, no law or regulation exists that dictates the specific method of producing such data. Since the proposed three-week audit had already extended to over three months at the time additional financial data was requested , we assumed that the auditors would want to be appraised of the likely amount of time it would take to assemble the interim accounts receivable data requested. ATC at no time refused to provide such information. We informed the auditors in our memo that it would take four weeks or more to provide the information requested, again due in part to the fact that we have a small staff and most of the work would have to be done on an overtime basis.

We would like to emphasize that ATC is not opposed to improving its systems and will review the recommendations to consider whether systems changes are warranted and feasible. Nonetheless, ATC does comply with applicable record keeping regulations and this finding should be dropped from the Final Report.