
SOUTHERN CAREERS INSTITUTE'S COMPLIANCE WITH THE 85 PERCENT RULE

FINAL AUDIT REPORT



Control Number ED-OIG/A06-90008
March 2000

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*U.S. Department of Education
Office of Inspector General
Dallas, Texas*

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UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

Control Number ED-OIG/A06-90008

David Meck, President
Southern Careers Institute, Inc.
2301 South Congress, Suite 24A
Austin, Texas 78704

Dear Mr. Meck:

This is our audit report, *Southern Careers Institute's Compliance With the 85 Percent Rule*. The report incorporates the comments you provided in response to a draft report which was provided to you. 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 U.S. Department of Education official, who will consider them before taking final Departmental action on the audit:

Mr. Greg Woods, Chief Operating Officer
Student Financial Assistance
ROB-3, Room 4004
7th and D Streets, SW
Washington, DC 20202-5132

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, we request receipt of your comments within 30 days.

In accordance with the Freedom of Information Act (5 U.S.C. §552), reports issued by the Office of Inspector General are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemption in the Act.

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

Sincerely,

Lorraine Lewis

Enclosure

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EXECUTIVE SUMMARY

Southern Careers Institute, Inc. (SCI), a proprietary school headquartered in Austin, Texas, did not qualify as an eligible institution for participation in the Title IV, Student Financial Assistance Programs because it received 86.7 percent of its revenue from Title IV sources during its fiscal year ended December 31, 1997. As a result, the school was ineligible to participate in the Title IV programs for the period January 1 through December 31, 1998. During 1998, SCI received \$7,233,741 of Title IV funds.

Under the Higher Education Act, proprietary institutions must derive at least 15 percent of their revenues from non-Title IV sources to participate in Title IV programs. Conversely, no more than 85 percent of total revenue may be derived from Title IV programs. This institutional eligibility requirement is commonly referred to as the 85 Percent Rule (now the 90 Percent Rule). SCI reported in its audited financial statements for the fiscal year ended December 31, 1997, that it met the requirements of the 85 Percent Rule. However, based on our review of cash revenue recorded in student ledger accounts for the year, we determined SCI had not met the 85 Percent Rule, primarily because it included a portion of its institutional scholarships in non-Title IV cash revenue. Although the institutional scholarships did not generate any cash revenue for the school, we determined that SCI had a valid scholarship selection process.

After our audit fieldwork was completed, the Department notified schools that with respect to valid institutional scholarships . . . *absent unusual circumstances, [it] does not intend to exercise its enforcement authority against institutions that count . . . scholarships as revenue solely on the grounds that the . . . scholarships fail to comply with cash basis accounting requirements.* By allowing institutional scholarships to be counted as non-Title IV cash revenue for 1997, SCI can demonstrate that it met the eligibility requirement with a score of 80.8 percent. The scholarship amounts claimed by SCI will not count as revenue for the calculation for audits submitted to the Department after June 30, 2000.

As a result of the Department's decision not to enforce the institutional eligibility requirement, we are not recommending that SCI return the \$7,233,741 of Title IV funds it disbursed during January 1 through December 31, 1998. However, we recommend that the Chief Operating Officer for Student Financial Assistance require SCI to amend its procedures for calculating the 90 Percent Rule for any audits submitted after June 30, 2000, to ensure institutional scholarships that do not generate cash revenue are not counted in the calculation.

SCI did not agree with our audit findings. However, the school stated it does not plan to contest the recommendation. We have paraphrased the school's response and provided additional OIG comments after the Recommendation section of this report. A copy of the response is included as an Appendix to this report.

AUDIT RESULTS

Southern Careers Institute, Inc. (SCI), did not derive at least 15 percent of its revenues from non-Title IV sources during its fiscal year ended December 31, 1997, and was not eligible to participate in the Title IV programs for the period January 1 through December 31, 1998. SCI reported in its 1997 audited financial statements that it received 81.0 percent of total revenue from Title IV sources. Based on our analysis of all fiscal year 1997 student ledger accounts, SCI actually received 86.7 percent of its total cash revenue from Title IV sources. SCI's calculation of the reported percentage could not be supported and included non-cash revenue from institutional scholarships.

Proprietary Schools are Required to Generate at least 15 Percent of Revenue from Non-Title IV Sources

The Higher Education Act (HEA), Section 481(b) states: . . . *the term "proprietary institution of higher education" means a school . . . 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), and is commonly called the 85 Percent Rule. The regulations also provide the following formula, at 34 CFR 600.5(d)(1), for assessing whether an institution has satisfied the requirement and specifies that amounts used in the formula must be received by the institution during its fiscal year.

*Title IV, HEA program funds the institution used to satisfy tuition, fees,
and other institutional charges to students.*

The sum of revenues generated by the institution from: Tuition, fees, and other institutional charges for students enrolled in eligible programs as defined in 34 CFR 668.8; and activities conducted by the institution, to the extent not included in tuition, fees, and other institutional charges, that are necessary for the education or training of its students who are enrolled in those eligible programs.

In April 1994, the Department published the final regulation to implement the above portion of the Higher Education Act. Title 34 CFR 600.5(d)(2)(i) specifies that the amounts used in the 85 Percent Rule calculation are Title IV funds and revenues received by the institution during the fiscal year. In the preamble to the final regulation, the Secretary stated:

. . . 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.

SCI's 1997 audited financial statements contained the statement that 81.0 percent of its total revenue was received from the Title IV programs. SCI determined this percent by converting accrued revenue amounts reported in the financial statements to cash revenue. However, records made available to us did not support the revenue amounts SCI used to convert accrual amounts to cash. As a result, we analyzed all transactions from January 1 through December 31, 1997, that were recorded in student ledger accounts. This analysis of 2,457 student ledgers showed that SCI received 86.7 percent of its total revenue from the Title IV programs and did not meet the 85 Percent Rule. Table 1 compares the SCI calculations to the OIG calculations.

TABLE 1
SCI and OIG Calculated Percentages of Title IV Revenue for
January 1 through December 31, 1997

Funding Source	SCI Calculation	OIG Calculation	Difference
Title IV	\$5,466,482	\$5,382,401	(\$84,081)
Non-Title IV	1,282,270	823,624	(458,646)
Total Revenue	\$6,748,752	\$6,206,025	(\$542,727)
Title IV Percent	81.0%	86.7%	5.7%

Although records provided did not support the amounts SCI used in its calculation, we were able to identify the reason for at least some of the \$458,646 difference in the non-Title IV amount. SCI included a portion (about \$314,000) of its institutional scholarships as cash revenue. Based on the records and explanations provided by the school, SCI deducted \$131,068 from the total institutional scholarship amount of about \$445,000 and included the remainder in the 85 Percent Rule calculation as non-Title IV cash revenue. SCI should not have included any of the \$445,000 in the calculation because no cash revenue from outside sources was realized from awarding the scholarships.

No explanation was provided as to why only a portion of the institutional scholarships was deducted. The SCI President stated he considered institutional scholarships to be allowable as non-Title IV revenue in the 85 Percent Rule calculation.

SCI procedures provided that institutional scholarships were available for high school graduates and GED recipients provided they enrolled in an SCI training program within six months of high school graduation or receipt of a GED certificate. The students had to complete the training program in which he or she was enrolled in order to receive the scholarship. Additionally, SCI offered institutional scholarships to students who were sponsored by state or local sponsors such as the Texas Rehabilitation Commission or Alamo Workforce Development Council, Inc. Scholarship amounts were recorded in the student's ledger account. The procedures stated that a scholarship check would be

written by the school from a SCI bank account, endorsed “Deposit Only”, and then sent to the corporate office to be signed and deposited into a different SCI bank account. SCI’s student ledger cards disclosed that 249 students had institutional scholarships amounts credited to their accounts ranging from \$50 to \$3,650 during calendar year 1997. We found that SCI adhered to its procedures for awarding institutional scholarships based on a random sample review of 25 student files from the universe of 249 students with institutional scholarships.

A purpose of the 85 Percent Rule was to encourage proprietary institutions to obtain non-Federal student aid funds from independent outside sources. The SCI institutional scholarships represented transfers of cash between SCI bank accounts and did not result in cash revenues from outside sources.

Institutions that fail to satisfy the 85 Percent Rule lose their eligibility to participate in Title IV programs on the last day of the fiscal year covering the period that the institution failed to meet the requirement [34 CFR 600.40(a)(2)]. As a result, SCI should have lost its eligibility to participate as of December 31, 1997. SCI disbursed \$7,233,741 of Title IV funds between January 1 and December 31, 1998.

After our audit fieldwork was completed, the Department notified schools that with respect to valid institutional scholarships . . . *absent unusual circumstances, [it] does not intend to exercise its enforcement authority against institutions that count . . . scholarships as revenue solely on the grounds that the . . . scholarships fail to comply with cash basis accounting requirements.* By allowing institutional scholarships to be counted as non-Title IV cash revenue for 1997, SCI can demonstrate that it met the eligibility requirement with a score of 80.8 percent. As a result of the Department’s decision not to enforce the institutional eligibility requirement, we are not recommending that SCI return the \$7,233,741 of Title IV funds it disbursed during January 1 through December 31, 1998. Scholarship amounts claimed by SCI will not count as cash revenue for the calculation for audits submitted to the Department after June 30, 2000.

RECOMMENDATIONS

We recommend that the Chief Operating Officer for Student Financial Assistance require SCI to amend its procedures for calculating the 90 Percent Rule for any audits submitted after June 30, 2000, to ensure institutional scholarships that do not generate cash revenue are not counted in the calculation.

SCI'S RESPONSE TO DRAFT REPORT

SCI disagreed with our conclusion that it did not comply with the 85 Percent Rule for the fiscal year ended December 31, 1997. However, SCI stated it does “. . . *not plan to contest the recommendation that no refund of federal funds be made.*”

The SCI President also stated they have always tried to comply with federal regulations and would never intentionally violate them and that “. . . *it is wrong that regulations allow for after-the-fact interpretations that may disallow funds already disbursed to students.*” He added that “. . . *it would be better from everyone's standpoint to provide warnings as to possible future ineligibility . . . rather than unrealistically ask for refund of funds that institutions cannot reasonably make.*” A copy of SCI's response is included as an Appendix to this report.

OIG'S REPLY TO RESPONSE

While SCI did not agree with our audit findings, the school's response did not contain any information that would cause us to change the audit findings and recommendation.

BACKGROUND

SCI was founded in 1960. It is a proprietary institution headquartered in Austin, Texas, with additional locations in Corpus Christi, Pharr, and San Antonio, Texas. SCI received initial approval to participate in Title IV programs in March 1991, and is accredited by the Accrediting Commission of the Council on Occupational Education. Among the vocational programs offered by the institution are Medical Assistant, Pharmacy Technician, and Administrative Assistant.

During the two year period ended December 31, 1998, SCI received about \$13 million in Title IV funds from the following programs: Federal Pell Grant Program, Federal Campus Based Program, Federal Family Education Loan Program and William D. Ford Federal Direct Loan Program.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our audit were to determine whether SCI derived at least 15 percent of its revenue from non-Title IV sources and properly reported the 85 Percent Rule percentage in its audited financial statements.

To accomplish our objectives, we obtained background information about the institution. We reviewed selected SCI files and the school's 1997 audited financial statements and compliance audit report. We also interviewed SCI officials and the independent public accountant who prepared the school's financial statements and compliance audit report, and reviewed the independent public accountant's workpapers.

We analyzed all 2,457 student ledger accounts to determine Title IV and non-Title IV revenue for the year ended December 31, 1997. We also obtained and reviewed data applicable to the school from the Department's National Student Loan Data System, Payment Management System, and Grants Administration and Payment System.

Our audit covered the school's fiscal year that ended December 31, 1997. We performed fieldwork at SCI headquarters in Austin, Texas, during March through August 1999. 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 our review, we assessed SCI's management control structure, as well as its policies, procedures, and practices applicable to the scope of the audit. We assessed the level of control risk for determining the nature, extent, and timing of our substantive tests. For the purpose of this report, we assessed management controls related to the institution's calculation and reporting of the percentage of revenues received from non-Title IV sources as required by the 85 Percent Rule.

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 in the procedures used to calculate the 85 Percent Rule percentage. The weaknesses are discussed in the AUDIT RESULTS section of this report.

Southern Careers Institute, Inc.

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(512) 448-4795

APPENDIX

March 15, 2000

Mr. Lee Greear, Acting Area Manager
U.S. Department of Education
Office of Inspector General
1999 Bryan Street, Suite 2630
Dallas, Texas 75201-6817

Re: Draft Audit Report – February 2000

Dear Mr. Greear,

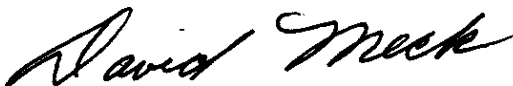
I do not agree with the findings in the draft report because we have always tried to comply with what we understand to be federal regulations. Also, we have been advised by attorneys, financial aid consultants, and CPA's who are familiar with regulations and they have advised us that what we have been doing is in compliance with regulations. We would never intentionally violate regulations.

While I do not agree with the audit findings, I do not plan to contest the recommendation that no refund of federal funds be made.

I eagerly await clarification of regulations from the U.S. Department of Education as to what regulations are intended to be. I assure you we will comply.

Also, I think it is wrong that regulations allow for after-the-fact interpretations that may disallow funds already disbursed to students. I believe it would be better from everyone's standpoint to provide warnings as to possible future ineligibility of an institution rather than unrealistically ask for refund of funds that institutions cannot reasonably make. Asking for refunds of funds that institutions do not have forces institutions to close and hurts students who are currently enrolled.

Sincerely,



David Meck
President
Southern Careers Institute, Inc.

DWM

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