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# Corinthian Colleges, Inc. Non-Title IV Revenue Percentage Calculations

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## FINAL AUDIT REPORT



**Audit Control Number ED-OIG/A09-90001  
February 2000**

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

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*Statements that management practices need improvement, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determination of corrective action to be taken will be made by the appropriate Department of Education officials.*

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UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

February 9, 2000

THE INSPECTOR GENERAL

**MEMORANDUM**

TO: Greg Woods  
Chief Operating Officer  
Student Financial Assistance

FROM: Lorraine Lewis *Lorraine Lewis*

SUBJECT: FINAL AUDIT REPORT  
*Corinthian Colleges, Inc.*  
*Non-Title IV Revenue Percentage Calculations*  
Audit Control No. ED-OIG/A09-90001

Attached is our subject audit report presenting our findings and recommendation resulting from our audit of Corinthian Colleges, Inc.

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 recommendation in this report.

If you have any questions or wish to discuss the contents of this report, please contact Gloria Pilotti, Area Manager, Sacramento, California at 916-498-6622. Please refer to the above audit control number in all correspondence relating to this report.

Attachment

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## Table of Contents

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	<u>Page</u>
<b>Executive Summary</b> .....	<b>1</b>
<b>Audit Results</b> .....	<b>3</b>
<i>Amounts Used in the Non-Title IV Revenue Percentage     Calculations Must Represent Revenue Received</i> .....	<i>3</i>
<i>Revenue Under Cash-Basis Accounting     Represent an Actual Inflow of Cash</i> .....	<i>4</i>
<i>CCI Improperly Included Amounts in Its Calculations     That Did Not Represent Cash Received</i> .....	<i>4</i>
<i>Recommendation</i> .....	<i>8</i>
<i>CCI's Comments</i> .....	<i>8</i>
<i>OIG Response</i> .....	<i>10</i>
<b>Other Matters</b> .....	<b>12</b>
<b>Background</b> .....	<b>13</b>
<b>Purpose, Scope and Methodology</b> .....	<b>14</b>
<b>Statement on Management Controls</b> .....	<b>15</b>
<b>Attachment –     Corinthian Colleges, Inc.'s Comments to the Report</b> .....	<b>16</b>

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## Executive Summary

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Corinthian Colleges, Inc. (CCI) used improper methodologies to calculate non-Title IV revenue percentages for institutions in each of its subsidiaries: Corinthian Schools, Inc. and Rhodes Colleges, Inc. During our audit period, CCI's subsidiaries received Title IV funds under 29 separate Office of Postsecondary Education Identifier (OPEID) numbers. The Higher Education Act (HEA), as amended, requires that a proprietary institution has a minimum percentage of its revenues from sources other than Title IV programs.

In its fiscal year 1997 and 1998 financial statements, CCI reported revenue percentages showing that institutions under each OPEID number met the non-Title IV revenue percentage requirement in those years. However, we found that CCI improperly included amounts that did not represent revenue received. Specifically, CCI improperly included the following amounts:

- ◆ institutional loan principal,
- ◆ institutional loan servicing fees,
- ◆ institutional scholarships,
- ◆ institutional matching contributions, and
- ◆ accrued grant funds.

These amounts did not represent non-Title IV revenue received by the institution in accordance with Title 34 of the Code of Federal Regulations (CFR), Section 600.5. Our recalculation of the revenue percentages found that one CCI institution, Las Vegas College (located in Las Vegas, Nevada) did not derive at least 15 percent of its revenues from non-Title IV sources in fiscal years 1997 and 1998. Another institution, Mountain West College (located in Salt Lake City, Utah) did not derive at least 15 percent of its revenues from non-Title IV sources in fiscal year 1998. As a result, these two institutions did not qualify as eligible proprietary institutions of higher education effective July 1, 1997 and July 1, 1998, respectively. Due to a policy statement contained in Dear Partner Letter GEN-99-33, we have not included recommendations in this report to either terminate the two institutions' participation in Title IV programs, or recover the Title IV funds received by the institutions.

In October 1999, the U.S. Department of Education, Student Financial Assistance (SFA) issued Dear Partner Letter GEN-99-33 informing the education community that SFA did not intend to exercise its enforcement authority against institutions that count valid loans and scholarships as revenue solely on the grounds that the loans and scholarships fail to comply with cash-basis accounting requirements. The Dear Partner Letter provided guidance for evaluating whether the loans and scholarships would be considered valid for purposes of the non-Title IV revenue calculation. Based on this guidance, we concluded that the CCI loans and scholarships were valid. With inclusion of institutional loan principal amounts in the revenue calculations, Las Vegas College and Mountain West College met the minimum non-Title IV revenue requirement.

CCI must take steps to correct its revenue calculation methodologies. Therefore, we recommend that the Chief Operating Officer (COO) for SFA require that CCI revise its calculation methodology to comply with Federal regulations and current SFA guidance.

In its comments to the draft report, CCI did not agree with our conclusions and recommendation. CCI's comments are summarized in the report and included as an attachment.

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## Audit Results

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We concluded that CCI used improper methodologies to calculate non-Title IV revenue percentages for institutions in its two subsidiaries: Corinthian Schools, Inc. (Corinthian) and Rhodes Colleges, Inc. (Rhodes). While CCI reported revenue percentages for each OPEID number in the notes to its subsidiaries' financial statements, the calculations supporting the percentages improperly included institutional loan principal, institutional loan servicing fees, institutional scholarships and institutional matching contributions that did not represent revenue received by the institution during the fiscal year. CCI also improperly included amounts from the Federal Pell Grant and Federal Supplemental Educational Opportunity Grant (FSEOG) programs that were not received by the institution during the fiscal year.

### *Amounts Used in the Non-Title IV Revenue Percentage Calculations Must Represent Revenue Received*

The 1992 reauthorization of the HEA added a provision requiring a proprietary institution to have “at least 15 percent of its revenues from sources that are not derived from funds provided under this title [Title IV programs], as determined in accordance with regulations prescribed by the Secretary.”<sup>1</sup> This institutional eligibility requirement is codified in Title 34 CFR Section 600.5(a)(8). The regulation provides the formula 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. 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; . . .**” [emphasis added]

Proprietary institutions that fail to satisfy the non-Title IV revenue percentage requirement 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.

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<sup>1</sup> The 1998 amendments to the HEA, enacted on October 7, 1998, changed the provision to require that a proprietary institution have at least 10 percent of its revenue from non-Title IV sources. This change will apply to CCI’s revenues for its fiscal year ending June 30, 1999.

## ***Revenues Under Cash-Basis Accounting Represent an Actual Inflow of Cash***

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 a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity’s 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 of the entity’s ongoing major or central operations.”<sup>2</sup> The accounting method that recognizes revenues when amounts are received is referred to as cash-basis accounting. In contrast, the accrual basis of accounting recognizes revenue when sales are made or services are performed, regardless of when cash is received.

When the Department issued the regulation covering institutional eligibility requirements on April 29, 1994, the Secretary specified in the preamble that “institutions will use a cash basis of accounting for both title IV, HEA program funds and revenues.” He further explained in the “Analysis of Comments and Changes” section of the Final Rule that “[u]nder a cash basis of accounting, the institution reports revenues on the date that the revenues are actually received.”

## ***CCI Improperly Included Amounts in Its Calculations That Did Not Represent Cash Received***

CCI improperly included institutional loan principal, institutional loan servicing fees, institutional scholarships, institutional matching contributions and accrued grant funds in its revenue percentage calculations.

- ◆ ***Institutional loan principal amounts included in CCI’s calculations did not represent non-Title IV cash received during the fiscal year.*** CCI used different methods to determine the institutional loan amounts used in the calculations for its two subsidiaries.

For Corinthian schools,<sup>3</sup> the institutional loan amounts used in the calculations consisted of two amounts: (1) payments received from current students during the fiscal year on outstanding loans, and (2) the remaining principal balance on loans for those students

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<sup>2</sup> 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.

<sup>3</sup> One exception is the Southfield campus. The institutional loan amounts used in the calculation consisted of the loan principal amounts at the time the loans were made. Per CCI official, this method was similar to the Rhodes schools since the Southfield campus offered longer programs.



who completed the program or left school during the fiscal year.<sup>4</sup> For Rhodes schools, institutional loan amounts used in the calculations consisted of the loan principal amount at the time the loan was made.<sup>5</sup>

In the preamble to the Final Rule, the Department stated its position on including institutional loans (and institutional scholarships) 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** by institutional scholarships and institutional loans as revenue... provided that the scholarships and loans are valid and not just 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.” [emphasis added]

While the preamble indicates that valid institutional loans could be included, the regulations stress that revenue used in the calculation must be received.<sup>6</sup> As mentioned earlier, cash-basis accounting recognizes revenue when cash is received (inflow of cash). Therefore, the institutional loan principal amounts should not have been included in the calculation as non-Title IV revenues. Instead, CCI should have included the borrower payments received on the school’s institutional loans during the fiscal year.

- ◆ ***CCI included fees paid to its institutional loan servicers as non-Title IV funds.*** CCI has agreements with TFC Credit Corporation and National Loan Servicing Center, Inc. to service its subsidiaries’ institutional student loan accounts. The servicers submit the borrower payments (net of servicing fees) to the corporation. CCI included the loan servicers’ fees as part of the non-Title IV funds. The loan servicing fees do not represent an inflow of cash to the institutions. Therefore, CCI should not have included the loan servicers’ fees in the revenue percentage calculations.

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<sup>4</sup> When the student graduates or leaves school, the remaining loan principal balance is recorded as a payment on the student account and the corresponding amount is recorded as a note receivable in the accounting records. CCI used the payments recorded on the student accounts to determine revenue amount for purpose of the non-Title IV revenue percentage calculation. The amounts subsequently collected on the remaining loan principal balance for students who have completed/left school were not included in the revenue percentage calculation.

<sup>5</sup> The principal portions of student payments received on these loans were not used in the revenue percentage calculations.

<sup>6</sup> We found that CCI’s institutional loans were valid, did not appear to be part of a scheme to artificially inflate tuition, and were routinely repaid by student borrowers.

- ◆ ***Institutional scholarship amounts included in CCI's calculations did not represent non-Title IV cash received.*** Various Corinthian and Rhodes schools awarded institutional scholarships to a few selected students. Each school offering scholarships had its own qualification requirements and the award amounts varied.

The preamble section of the Final Rule, cited previously, indicated that institutional scholarships could be included as revenue provided that the scholarships are valid. The institutional scholarships appeared to be valid. However, CCI did not have an external source for institutional scholarship funds. The institutional scholarship amounts were recorded as tuition reduction. These transactions were non-cash accounting entries and did not represent inflows of cash to the institution. As we noted earlier, the regulation stresses that revenue used in the calculation must be received (inflow of cash). Therefore, CCI should not have included the institutional scholarships in the revenue percentage calculations.

- ◆ ***Institutional matching contributions included in CCI's calculations did not represent non-Title IV cash received.*** CCI included the required 25 percent institutional contribution for the FSEOG program as part of the non-Title IV receipts. According to the CCI official, the FSEOG matching contribution was treated as an expense to the institution. For example, if a student were awarded \$100 in FSEOG, the institution would record \$100 as tuition received, \$75 as FSEOG cash received from the Department and \$25 as FSEOG matching contribution expense. The institution's matching portion of this transaction does not represent an inflow of cash to the institution. Therefore, CCI should not have included the institutional matching contributions in the revenue percentage calculations.
- ◆ ***Accrued Pell Grant and FSEOG amounts included in CCI's calculations did not represent Title IV cash received during the fiscal year.*** For Rhodes schools, CCI included amounts from the Federal Pell Grant and FSEOG programs that were not received by the institution during the fiscal year. The Rhodes schools receive Pell Grant and FSEOG funds under the reimbursement method.<sup>7</sup> A CCI official explained that the Department required schools to record the Pell Grant and FSEOG amounts in student ledgers before requesting reimbursement from the Department. For the revenue percentage calculations, CCI used the accrued amounts of Pell Grant and FSEOG as Title IV funds. CCI should have only included the Pell Grant and FSEOG funds that were actually received from the Department during the fiscal year.

In its fiscal year 1997 and 1998 financial statements for Corinthian Schools and Rhodes Colleges, CCI reported that institutions under all 29 OPEID numbers met the non-Title IV revenue percentage requirement. After adjusting CCI's calculations for the above amounts that were improperly included in the calculations, we concluded that two Rhodes' institutions failed to meet the minimum non-Title IV revenue percentage. Las Vegas College did not derive at least 15 percent of its revenues from non-Title IV sources during fiscal years ended June 30, 1997 and 1998. Mountain West College did not derive at least 15 percent of its revenues from non-Title IV sources during fiscal year ended June 30, 1998. Proprietary institutions that fail to satisfy the non-Title IV revenue percentage requirement lose their

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<sup>7</sup> Corinthian schools received Title IV grant funds under a method other than the reimbursement method.

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. Therefore, Las Vegas College and Mountain West College did not qualify as eligible proprietary institutions of higher education as of July 1, 1997 and July 1, 1998, respectively.

In October 1999, SFA issued Dear Partner Letter GEN-99-33. The letter informed the education community that SFA did not intend to exercise its enforcement authority against institutions that count valid loans and scholarships as revenue solely on the grounds that the loans and scholarships fail to comply with cash-basis accounting requirements. The Dear Partner Letter provided guidance for evaluating whether the loans and scholarships would be considered valid for purposes of the non-Title IV revenue calculation. Based on this guidance, we concluded that the CCI loans and scholarships were valid. The institutional loans and scholarships were applied to the student accounts during the fiscal year. The institutional loans were documented and did not appear to be part of a scheme to artificially inflate tuition. Student borrowers routinely repaid the loans. CCI's institutions had established scholarship criteria that provided scholarships for a small percentage of students.

Tables 1 and 2 compare the percentages of non-Title IV revenues as reported by CCI, calculated by the OIG and after application of the guidance provided in the Dear Partner Letter.

**Table 1. Las Vegas College.** *In fiscal years 1997 and 1998, Las Vegas College did not have sufficient non-Title IV revenues to meet the minimum non-Title IV revenue requirement. However, after application of the SFA guidance issued in Dear Partner Letter GEN-99-33, Las Vegas College met the minimum requirement for both years.*

<b>Las Vegas College</b>						
<b>Revenues Received</b>	<b>1997 (15% Minimum )</b>			<b>1998 (15% Minimum)</b>		
	<b>Per School</b>	<b>Per OIG</b>	<b>Per SFA Guidance</b>	<b>Per School</b>	<b>Per OIG</b>	<b>Per SFA Guidance</b>
<b>Title IV Revenue</b>	\$1,619,001	\$1,689,958	\$1,689,958	\$1,427,732	\$1,430,177	\$1,430,177
Non-Title IV Revenues:						
Institutional Loans <sup>8</sup>	114,070	35,833	115,591	217,760	44,369	212,914
Other	177,956	182,622	182,622	99,166	99,166	99,166
Sub Total Non-Title IV Revenues	292,026	218,455	298,213	316,926	143,535	312,080
<i>Addition:</i>						
Institutional FSEOG Match	7,253	0	0	6,169	0	0
<b>Total Non-Title IV Revenues</b>	\$299,279	\$218,455	298,213	\$323,095	\$143,535	\$312,080
<b>Total Revenues</b>	\$1,918,280	\$1,908,413	\$1,988,171	\$1,750,827	\$1,573,712	\$1,742,257
<b>Non-Title IV Revenue as a Percent of Total Revenues</b>	<b>15.60%</b>	<b>11.45%</b>	<b>15.00%</b>	<b>18.45%</b>	<b>9.12%</b>	<b>17.91%</b>

<sup>8</sup> CCI obtained ownership of Las Vegas College during fiscal year 1997. The institutional loan amounts shown in the "Per OIG" and "Per SFA Guidance" columns include amounts for the period during fiscal year 1997 that Las Vegas College was under its former owner. CCI did not include these amounts in its calculations.

**Table 2. Mountain West College.** In fiscal year 1998, Mountain West College did not have sufficient non-Title IV revenues to meet the minimum non-Title IV revenue requirement. However, after application of the SFA guidance issued in Dear Partner Letter GEN-99-33, Mountain West College met the minimum requirement.

Revenues Received	1998 (15% Minimum)		
	Per School	Per OIG	Per SFA Guidance
<b>Title IV Revenue</b>	\$1,770,541	\$1,779,651	\$1,779,651
Non-Title IV Revenues:			
Institutional Loans	286,730	96,371	279,363
Other	214,993	214,993	214,993
Sub Total Non-Title IV Revenues	501,723	311,364	494,356
<i>Adjustment:</i>			
Institutional FSEOG Match	11,791	0	0
<b>Total Non-Title IV Revenues</b>	\$513,514	\$311,364	\$494,356
<b>Total Revenues</b>	\$2,284,055	\$2,091,015	\$2,274,007
<b>Non-Title IV Revenue as a Percent of Total Revenues</b>	<b>22.48%</b>	<b>14.89%</b>	<b>21.74%</b>

After including the institutional loan principal amounts, both Las Vegas College and Mountain West College met the minimum non-Title IV revenue requirement. Therefore, we have not included recommendations in this report to either terminate the two institutions participation in Title IV programs, or recover the Title IV funds received by the institutions.

The policy guidance provided in the Dear Partner Letter will remain in effect until the new regulations published in the October 29, 1999 Federal Register go into effect on July 1, 2000. The new regulation explicitly states that an institution must use the cash-basis of accounting and that, under cash-basis accounting, the institution must include only the amount of loan repayments received by the institution during the fiscal year. For institutional scholarships, the institution must include only the amount of funds it disbursed during the fiscal year from an established restricted account and only to the extent that the funds in the account represent designated funds from an outside source or income earned on those funds. Therefore, in the future, CCI will need to revise its methodology to fully comply with the requirement that amounts included in calculations are on a cash-basis of accounting.

### **Recommendation**

We recommend that the Chief Operating Officer of SFA require that CCI revise its calculation methodology to comply with Federal regulations and current SFA guidance.

### **CCI's Comments**

CCI did not agree with our conclusions and recommendation. CCI maintained that each of its institutions met the non-Title IV revenue requirement and CCI had accurately and correctly calculated the revenue percentages based on the regulatory policy guidance available during the audited periods. CCI stated that its methodology was based upon a statement confirmed by a staff member in the Department's Policy Development Division, the OIG's *Audit Guide for*

*Compliance Audits (Attestation Engagements) of Federal Student Financial Assistance Programs at Participating Institutions* and its certified public accountant (CPA) firm's understanding of the requirements set forth in the regulations. CCI stated that the positions taken by the OIG in the audit report were not consistent with the above guidance.

CCI stated that the OIG issued a new interpretation of the regulations in its April 1999 Dear CPA Letter. Specifically, CCI claimed that the Dear CPA Letter contained a "new definition" of revenue for institutional loans, scholarships and matching contributions. CCI stated that the OIG is seeking to retroactively apply the "new definition."

Institutional loan principal. CCI stated that the OIG's "new definition" of revenue for institutional loans was not supported by either the language of the regulations or the preamble accompanying the April 29, 1994 publication of the regulations. CCI also noted that the following statement, confirmed by Policy Development Division staff, had not been rescinded by SFA: ". . . institutional loans made by institutions to its students are included in the year they are made[emphasis added], if such loans are valid and not part of a scheme to artificially inflate the institution's tuition and fee charges."

Institutional loan servicing fees. CCI stated that these fees were an operating expense, not a reduction of the amount paid by students. The fact that the loan servicer and CCI chose to have the servicer receive payment of its fees from the collected student loan payments did not alter the amount of money that was being paid by students to CCI. A June 14, 1999 letter from its CPA firm supported CCI's position.

Institutional scholarships. CCI stated that its scholarship funds represent a reduction in tuition and fees charged to students who meet specific, well-defined criteria entitling them to a scholarship. The institution deducted the scholarship amount from the outstanding balance on the student's payment ledger. CCI believed that this treatment of scholarship funds, while not offset from funds from an endowment or trust, is revenue.

Institutional matching contributions. CCI stated that it applied the entire FSEOG disbursement to student ledgers, which consisted of 75 percent Title IV funds and 25 percent non-Title IV funds, thereby, representing payment to student accounts. CCI claimed that crediting student accounts for payment should be treated as "cash." The fact that CCI's institutions did not pay the institutional match to each student individually did not reduce that institution's revenue. The June 14, 1999 letter from its CPA firm supported this position.

CCI also referred to the preamble language that states "an institution should not include institutional matching funds in the numerator as part of its Title IV HEA program funds." CCI concluded from this statement that institutional matching contributions can and must be included in the denominator.

Accrued grant funds. CCI cited the Federal regulations covering the reimbursement payment method that state: "The Secretary considers an institution to have made a disbursement if the institution has either credited the student's account or paid a student or parent directly with its own funds." CCI concluded that this regulation dictates that the funds be considered revenue. CCI also referred to the June 14, 1999 letter from its CPA, which stated that the institutions have "constructive receipt" of Title IV funds at the time the student account is credited. The CPA

firm stated that “constructive receipt” is a cash-basis concept used by the Internal Revenue Service to define when the cash revenues must be included for tax purposes.

**Recommendation.** CCI stated that the OIG’s interpretation of the regulations covering the non-Title IV revenue requirement was not the only acceptable, reliable, substantiated methodology under Generally Accepted Accounting Principles (GAAP). However, CCI agreed to comply with revised regulatory policy if SFA officially embraced the OIG’s interpretation. In its response to the draft report, CCI provided revenue percentages for fiscal year 1999 for the two institutions that failed to meet the minimum revenue percentage. The non-Title IV revenue percentages for the Las Vegas College and Mountain West College, using the OIG methodology, were 83.26 percent and 83.93 percent, respectively.

### ***OIG Response***

We did not change our conclusions based upon CCI’s comments. However, we revised our recommendations based on the SFA policy guidance issued in Dear Partner Letter GEN-99-33.

The OIG did not create a “new definition” of revenue in its April 1999 Dear CPA Letter. The definition for revenue used in the April 1999 Dear CPA Letter, and this report, was issued by FASB. FASB is the designated organization in the private sector for establishing standards of financial accounting and reporting. The regulations clearly state that amounts used in the revenue calculation must represent revenue received. The Preamble to the Final Rule, issued on April 29, 1994, clearly stated that institutions will use a cash-basis of accounting for amounts included in revenue calculations.

The conclusions presented in this report are also supported by the final regulations issued by the Department on October 29, 1999. In the preamble to the notice of proposed rulemaking for these regulations, the Secretary noted that questions arose, after issuance of the April 1994 final regulations, with regard to the treatment of institutional loans and scholarships under the cash-basis of accounting. Due to these questions, and in order to remove any apparent or perceived ambiguities that may exist with regard to the regulations, the Secretary proposed a number of clarifications regarding the non-Title IV revenue requirement. The resulting final regulations are clear that an institution must use the cash-basis of accounting, and that cash-basis accounting recognizes revenue when cash is received by the institution from an outside source. The regulations contain specific provisions on institutional loans, scholarships and matching contributions that support conclusions contained in this report.

**Institutional loan principal and institutional scholarships.** Statements confirmed by Department staff do not have the same legal force as regulations issued pursuant to formal rulemaking. However, in Dear Partner Letter GEN-99-33, SFA recognized the existence of differing interpretations of the preamble statements to the April 1994 regulations. In the letter, SFA noted that some institutions had concluded that the preamble statements regarding institutional loans and scholarships superseded the general requirement that amounts included in the revenue calculations must be revenue under a cash-basis of accounting. Due to the differing interpretations, SFA issued the policy that the Department, absent unusual circumstances, does not intend to exercise its enforcement authority against institutions that count institutional loans

as revenue solely on the grounds that the loans and scholarships fail to comply with the cash-basis accounting requirements. We revised our recommendations to reflect this SFA policy.

Institutional loan servicing fees. CCI's institution did not actually receive the portion of the student payments that was retained by the loan servicer. Therefore, these amounts do not represent revenue received by the institution and cannot be included in the revenue calculation.

Institutional matching contributions. Institutional matching contributions do not represent inflows or other enhancements of the institution's assets or settlements of its liabilities. Therefore, matching contributions do not meet the FASB definition of revenue.

The preamble to the April 1994 regulations did state that matching funds should not be included in the numerator of the calculation. However, the absence of a statement regarding the denominator does not negate other statements contained in the preamble. As mentioned previously, the preamble contained a clear statement that an institution must use a cash-basis of accounting for amounts included in the revenue calculation.

Accrued grant funds. Regulations governing the reimbursement payment method and Internal Revenue Service guidelines are not applicable to the revenue calculation.

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## Other Matters

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***Perkins Loan Amounts in CCI's Percentage Calculations.*** The institutions under Corinthian Schools, Inc., participate in the Title IV Perkins Loan Program.<sup>9</sup> The transactions for the Perkins Loan Program include the Federal Capital Contribution (FCC), institution's capital contribution (required institutional match), Perkins Loan disbursements and borrower payments (principal and interest) on Perkins Loans. As mentioned in the Audit Results section, under cash-basis accounting, amounts used in the revenue percentage calculation must represent cash received by the institution during the fiscal year. We believe that only the FCC and borrower payments provide an inflow of cash (revenue received) to institutions.

CCI management informed us that Corinthian schools did not receive an FCC for Perkins Loans in FY 1998. However, student payments were collected for outstanding Perkins Loans and placed in the revolving Perkins Loan accounts. CCI made new loan disbursements to students from the revolving accounts. CCI included Perkins Loan disbursements, made from its institution's Perkins Loan Program revolving fund, as Title IV funds in the revenue percentage calculation.

In SFA Action Memorandum No. 99-7 issued January 8, 1999, we alerted the Department about the need to provide guidance to institutions on the amounts that institutions should include in the revenue percentage calculation for the Perkins Loan Program.

***CPA Review of CCI's Percentage Calculation.*** During our fieldwork, we met with representatives of the Certified Public Accountant (CPA) firm that audited CCI's financial statements for the fiscal years ended June 30, 1997 and 1998. The CPA firm's representatives explained that they used guidance from Federal regulations, the Federal Register, national organizations, third-party servicers and the accounting firm that performed CCI's student financial assistance compliance audit. The CPA firm's review included tests of cash receipts, verification of source information and review of bank statements and student ledgers. The representatives stated that they did not identify problems with CCI's calculations or its supporting documentation. However, as we disclosed in the Audit Results section, CCI used improper methodologies to calculate the revenue percentages. The incorrect amounts included institutional loan principals, institutional loan servicing fees, institutional scholarships, institutional matching contributions for FSEOG and accrued Pell Grant and FSEOG receipts.

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<sup>9</sup> Institutions under the Rhodes subsidiary did not participate in the Perkins Loan programs during the period covered by our review and do not currently participate in the program.



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## Background

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CCI, through its wholly-owned subsidiaries, Corinthian Schools, Inc. and Rhodes Colleges, Inc., operates degree and non-degree granting proprietary schools. CCI used the services of Global Financial Aid Services, a third-party school servicer. The corporate headquarters is located in Santa Ana, California.

CCI was founded in February 1995 and acquired certain schools from National Education Centers, Inc. (NEC). CCI acquired 16 NEC schools in 1995 and two additional campuses in 1996.<sup>10</sup> During fiscal year 1998, CCI operated these schools through the Corinthian Schools subsidiary. Campuses under Corinthian Schools are located in Virginia, West Virginia, Texas, Michigan, Massachusetts, Louisiana, Washington and California. Corinthian schools offer non-degree programs in the medical, dental, business and technology fields, and are accredited by the Accrediting Commission of Career Schools and Colleges of Technology or the Accrediting Council of Independent Colleges and Schools.

In October 1996, CCI purchased 18 campuses from Phillips Colleges, Inc. During fiscal year 1998, CCI operated these schools through its Rhodes Colleges subsidiary.<sup>11</sup> Campuses under Rhodes Colleges are located in Oregon, Colorado, Nevada, Utah, Missouri, Pennsylvania, New York, Washington and Florida. Rhodes Colleges offer degree programs in accounting, business, healthcare and computers, and are accredited by the Accrediting Council of Independent Colleges and Schools. Rhodes Colleges receive Federal Pell Grant, Federal Supplemental Educational Opportunity Grant and Federal Work Study funds under the reimbursement method.

During the period July 1, 1996, through December 31, 1998, CCI received a total of about \$180 million in Title IV funds from the following programs: Federal Pell Grant, Federal Supplemental Educational Opportunity Grant and Federal Family Education Loan. CCI also participated in the Federal Perkins Loan and Federal Work Study Programs. CCI has continued to receive Title IV funds for the period after December 31, 1998.

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<sup>10</sup> The Sacramento campus (a former NEC school) was closed in December 1997.

<sup>11</sup> Rhodes Colleges has two wholly-owned subsidiaries, Florida Metropolitan University, Inc. and Rhodes Business Group, Inc. Rhodes Colleges and its subsidiaries operated the 18 campuses. References in this report to Rhodes Colleges include its subsidiaries.

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## Purpose, Scope and Methodology

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The purpose of our audit was to determine if CCI institutions derived at least the minimum required percentage of their revenues from non-Title IV sources and that CCI properly reported the Title IV revenue percentages in its financial statements.

To accomplish our objective, we obtained background information about the institution and identified the Department's OPEID numbers under which the institution received its Title IV funds. We reviewed the financial statements for CCI's subsidiaries, Corinthian Schools and Rhodes Colleges. We also reviewed selected SFA audit reports prepared by CCI's CPA firm. We conducted interviews with CCI officials and reviewed student records. We assessed whether the institution used the non-Title IV revenue percentage formula in the regulations, and reviewed the financial statements for proper disclosure of the percentage.

To achieve our audit purpose, we obtained and analyzed CCI's revenue percentage calculations for all institutions under each of the 29 OPEID numbers. We analyzed data extracted from CCI's student account ledgers, which were maintained on a computerized database. Information from student account ledgers that was used as a basis for our audit conclusion was traced to other sources, such as institutional bank statements, school servicer records and student records. We used data extracted from the Department's National Student Loan Data System (NSLDS) for comparative purposes and reports generated from the Department's Postsecondary Education Participants System (PEPS) for background information purposes.

Our audit covered the institution's fiscal year ending June 30, 1998. After determining that two Rhodes schools did not meet the non-Title IV revenue requirement for fiscal year 1998 (minimum 15 percent), we expanded our review to include the fiscal year ended June 30, 1997 for the two schools.<sup>12</sup> For this prior year, we evaluated the types of revenues included in CCI's calculations, and determined that these two schools did not meet the minimum percent requirement.

We performed fieldwork at CCI's corporate office and at two campuses in Southfield, Michigan and Las Vegas, Nevada. We also performed fieldwork at CCI's Audit Compliance Department and its school servicer, both located in Gulfport, Mississippi. Fieldwork was conducted in October and December 1998, and in January and February 1999. Our audit was performed in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.

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<sup>12</sup> The fiscal year ending June 30, 1997 is CCI's first fiscal year for calculating the revenue percentages for Rhodes schools since acquiring the schools from Phillips Colleges, Inc.

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## Statement on Management Controls

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As part of the review, we assessed CCI's management control structure, and 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 this report, we assessed management controls related to the institutions' calculations of revenues from non-Title IV sources and reporting of its Title IV revenue percentages.

Based on our assessment, the management control structure was sufficient to prevent or detect errors or irregularities in the non-Title IV revenue percentage calculations. However, 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.

The Audit Results section of this report disclosed that CCI improperly included amounts in its calculation of non-Title IV revenue that did not represent cash received by its institutions. This condition resulted from a misinterpretation of Federal regulations rather than a weakness in CCI's management control structure.

## **Attachment**

### **Corinthian Colleges, Inc.'s Comments to the Report**

#### OIG Note

This attachment contains only those portions of CCI's comments applicable to statements, conclusions and recommendation presented in the final report. Upon request, our office will provide a full copy of CCI's response with its attachments.

The OIG provided three draft reports to CCI for its comment: Corinthian Colleges, Inc. (Audit Control No. ED-OIG/A09-90001), Mountain West College (Audit Control No. ED-OIG/A09-90015) and Las Vegas College (Audit Control No. ED-OIG/A09-90016). The draft reports and CCI's comments on those reports were consolidated and presented in this final report.



July 22, 1999

Ms. Gloria Pilotti  
Regional Inspector General for Audit  
Region IX  
U. S. Department of Education  
801 I Street, Room 219  
Sacramento, CA 95814

Re: Responses to Draft Audit Reports for Non-Title IV  
Revenue Percentage Calculations for –  
Corinthian Colleges, Inc., Audit Control Number A0990001  
Mountain West College, Audit Control Number A0990015  
Las Vegas College, Audit Control Number A09900016

Dear Ms. Pilotti:

We appreciate the opportunity to respond to the draft audit reports for Non-Title IV Revenue Percentage Calculations issued by the OIG on May 27, 1999.

Separate responses have been prepared and are enclosed for each draft report which follow the same format as the draft reports. Each response details the reasons we disagree with the findings and includes supporting documentation for each of the findings cited in each report.

CCI maintains that each of its institutions are in compliance with the 85 Percent Rule, and believe that this report will show that based on the regulatory policy guidance available during the audit periods under review we accurately and correctly calculated our percentages.

We trust this information sufficiently addresses your concerns and believe the recommendations for termination of eligibility for our two institutions and the "material weakness" in control structure citation for the Corporation will be rescinded upon your review of our responses.

Again, we appreciate the opportunity to present this information and the thirty day extension granted to us to prepare our response. Should you have questions or require additional information please feel free to contact me or Linda K. Buchanan at (228) 867-1905.

Sincerely,

A handwritten signature in cursive script that reads "David Moore".

David Moore, President/CEO  
Enclosures

CORINTHIAN COLLEGES, INC.

6 Hutton Centre Drive, Suite 400 • Santa Ana, CA 92707-5764 • (714) 427-3000 • FAX (714) 427-5111

***CCI Improperly Included  
Amounts in Its Calculations That  
Did Not Represent Cash Received***

- *Institutional loan principal amounts included in CCI's calculations did not represent non-Title IV cash received during the fiscal year.*

**CCI'S RESPONSE:**

CCI takes exception to the OIG's assertion that "Institutional loan principal amounts included in CCI's calculations did not represent cash received during the fiscal year." The report further states "While the preamble indicates that institutional loans could be included, the regulations stress that revenue used in the calculation must be received."

CCI did include the full principal of institutional loans in the calculation, as allowed in the regulations issued on April 29, 1994. Furthermore, CCI developed its methodology for calculating the 85 Percent Rule based upon regulatory guidance available to the industry during the relevant audit years.

In a good faith effort to ensure compliance, CCI sought and used consistent guidance that came from several different sources. As this response indicates, CCI's methodology was based upon Department of Education guidance from its policy division, OIG guidance provided during the reporting years in question, and the interpretation of the independent certified public accountants that attested to, and later certified, CCI's internal calculations. A detailed description of the guidance that was used follows:

**Department of Education Guidance**

The education industry received guidance from the Division of Policy Development at the US Department of Education (ED) regarding the inclusion of institutional loans in the denominator for purposes of calculating the 85 Percent Rule. In a letter dated May 13, 1994 (within two weeks of promulgation of the final regulations), a specific request for clarification of interpretation was submitted to Cheryl Leibovitz, Senior Program Specialist, General Provision Branch Division of Policy Development, US Department of Education. A concurrence with the interpretation that "...institutional loans made by institutions to its students are included in the year they are made, [emphasis added] if such loans are valid and not part of a scheme to artificially inflate the institution's tuition and fee charges" was requested. On August 24, 1994, Cheryl Leibovitz confirmed that interpretation. A copy of this letter is attached as Exhibit A. As stated in this report, the OIG examined CCI's institutional scholarship and loan programs and determined them to be valid.

**Office of Inspector General Guidance**

The OIG issued a revised Audit Guide in June 1995. The guidance provided at that time is found on page I-8 and states "85/15 Attestation. ED will provide guidance which will address the 85/15 attestation, which is effective July 1, 1995, and other financial statement issues." A copy of this page is attached as Exhibit B-1. The OIG again revised the Audit Guide in June 1997. Changes to the portion pertaining to the 85/15 Attestation are found

on page 2 of the June 1997 Update that states “85/15 Attestation. Delete the word Attestation and insert *Revenue Test*. Delete the sentence: ED will provide guidance which will address the 85/15 attestation; which is effective July 1, 1995, and other financial statement issues. Insert a new sentence: *A proprietary institution must disclose in a footnote to its audited financial statements the percentage (including the figures used to make the calculation) of its revenues derived from the Title IV funds received during the fiscal year covered by that audit (34 CFR 668.23). The calculation must be made on a cash basis and in accordance with 34 CFR 600.5.*” A copy of that update is attached as Exhibit B-2.

#### Independent CPA Interpretation

CCI also sought and received guidance and an interpretation from its independent certified public accountants. In order to clarify the information provided to the school during this period, the Certified Public Accountant firm which reviewed and attested/certified CCI's calculations has issued a position letter stating their understanding of the requirements set forth in the regulations issued on April 29, 1994. A copy of their letter is enclosed as Exhibit C.

Now, four years after the first attestations were due on July 1, 1995, and a year after the latter of the two audit periods in question was concluded, the OIG has published new interpretations, markedly different from ED's 1994 policy guidance, which the OIG is seeking to retroactively apply to prior audit years. CCI in good faith structured and conducted operations in past audit years based on ED's written 1994 policy guidance. Significantly, in a March 20, 1997 statement to Congress, the Inspector General expressed concern about the clarity of ED's policy guidance on the 85 Percent Rule. The Inspector General noted that “the Department has provided inconsistent guidance for implementation of the 85/15 Rule”, (March 20, 1997, Statement of Thomas R. Bloom before the Subcommittee on Human Resources of the House Committee on Government Reform and Oversight), yet the OIG took no steps at that time to advise the industry of what it believed to be the correct understanding of the 85 Percent Rule.

The OIG's new interpretation, detailed in a May 1999 “Dear CPA Letter” which went directly to CPA's and not to the institutions, contains the OIG's “new definition” of revenue for institutional loans, scholarships, and institutional matching contributions. This clearly is a new interpretation, one that encompasses many new definitions, and it was published and articulated almost a full audit period after the reporting periods in question. A copy of the “Dear CPA Letter” is enclosed as Exhibit D. (See OIG Note)

Recently, the Department of Education, which is responsible for setting institutional eligibility policy through regulations, issued a Notice of Proposed Rulemaking (NPRM) proposing new Regulations which adopt the OIG's new interpretations. However, before the NPRM can be published as a Final Rule, the higher education community will have an opportunity to comment on the NPRM and at the Secretary's discretion changes to the NPRM could be made See 20 U.S.C. Section 1089(c)(1). In any event, even if the Department decides to maintain the new definitions of the OIG as policy, under the Master Calendar requirements adopted in the 1998 Amendments to the Higher Education Act of 1965, these changes will not become effective until July 1, 2000. This earliest possible effective date, will be two years after the conclusion of the most recent audit period reviewed in this report.

*OIG Note: The Dear CPA Letter referred to in this paragraph was issued in April 1999 rather than May 1999.*

In addition, contrary to the OIG's statement in its audit report, the OIG's current definition of revenue for institutional loans is not supported by either the language of the regulation (34 CFR Section 600.5) or the preamble accompanying the April 29, 1994 publication of the regulation. The regulation itself did not address the treatment of institutional loans, and the preamble did not state that it is improper for an institution to include the full principal of an institutional loan in the denominator of the 85 Percent calculation for the fiscal year in which the loan was made to the student. Rather, the preamble implicitly acknowledges that when a student uses the full principal of the institutional loan, during the fiscal year in which the loan was made, to meet tuition and related charges, the institution may include the full principal in its 85 Percent calculation as long as the Institutional loans are valid and are routinely repaid. The preamble reference to routine repayments as a measure of the validity of a loan would be unnecessary and meaningless if, as the OIG now contends, only loan installments made during the fiscal year may be included in the 85 Percent calculation. Therefore, it is readily apparent that the full principal amount of valid institutional loans can be counted in the fiscal year in which they are made.

In light of these factors, and the fact that the policy guidance given by Cheryl Leibovitz has never been rescinded by ED, nor was it ever publicly repudiated by the OIG until long after the close of the audit years at issue, CCI maintains its belief that, based on the regulatory guidance available during the audit years in question, it correctly calculated and reported its compliance with the 85 Percent Rule.

Therefore, CCI believes that it is in compliance with the 85 Percent Rule requirements related to institutional loans, as they existed during the relevant audit years, and requests that this issue be closed without further action on the part of its Institutions.

- *CCI included fees paid to its institutional loan servicers as non-Title IV funds.*

**CCI's RESPONSE:**

CCI disagrees with this interpretation. CCI did include fees paid to its loan servicer in its report of its 85 Percent Rule to ED. The calculation included total principal loan amounts (disbursed to students during the fiscal year and paid by them to the institution), interest, and fees paid by students (in repayment) in its original report of its 85 Percent Rule. These amounts all meet the requirements set forth in regulations issued on April 29, 1994, as previously stated. CCI did not include principal amounts repaid by borrowers in repayment in its calculation.

During the OIG's audit, CCI was asked to provide the payment history from its loan servicer (TFC) for the period of review. It was at this point in the audit process CCI was made aware that the OIG had a "new definition" of revenue as it relates to the 85 Percent Rule. CCI provided to the OIG the complete payment history for its institutional loans for the audit period, which reflected total amounts paid by students and posted to the student accounts in Notes Receivable. The OIG used the principal, interest, and fees paid by students, i.e. late fees, return checks, etc. representing amounts repaid by borrowers as the institutional loan amount, in their calculation. However, the OIG excluded that portion of loan payment that was retained by the servicer as its fees. These fees were an operating expense item for CCI, not a reduction of the amount paid to CCI by the student. These fees were deducted, by the loan servicer, from the amount paid by the student.



The fact that the loan servicer and CCI chose to have the servicer receive payment of its fees out of student loan payments to CCI does not alter the amount of money that was being paid by the students to CCI to reduce their outstanding loans. Of course, CCI could have chosen to receive the full amount of each loan installment payment, to deposit such payment to its operating account, and then to turn around and make payment to the servicer of its fees just as CCI makes payment out of its operating account for other expenses. But the means CCI chose of authorizing the servicer to withhold a portion of the loan payment as satisfaction of its fees does not and should not alter CCI's income and expense accounting. CCI posted the total amount paid by the student to the notes receivable and did not deduct the loan servicing fees from the student payment. The accuracy of this method is further supported by CCI's Certified Public Accountant. This issue is addressed further in the Independent Certified Public Accountant's position letter enclosed as Exhibit C.

CCI requests that this issue be closed without further action on the part of its Institutions.

- *Institutional scholarship amounts included in CCI's calculations did not represent non-Title IV cash received.*

#### **CCI'S RESPONSE:**

CCI disagrees with the OIG that it should not have included the institutional scholarships in the revenue percentage calculations. CCI is not structured in such a manner to have "an external source for institutional scholarship funds", nor does it believe that it needs to be in order to count legitimate scholarships as revenue for the purpose of the 85 Percent Rule.

As indicated by the OIG report, CCI scholarships are valid. They are based on specific criteria established by the institution and are "not part of a scheme to artificially inflate an institution's tuition and fee charges", as discussed in the *Analysis of Comments and Changes* of the Final Regulations highlighted earlier in this report.

The scholarship funds are, in fact, a reduction in tuition and fees charged to students who meet specific, well defined criteria entitling them to a scholarship, which the institution deducts from their payment ledger. CCI believes strongly that this treatment of scholarship funds, while not offset from funds from an endowment or trust fund, is revenue.

To illustrate that CCI's interpretation is consistent with that of the guidance provided by ED on this issue we refer you to a recent quote from Brian Kerrigan, Deputy Director, Office of Student Financial Assistance Program, Policy Training and Analysis Service Division. In response to questions posed by Eli Lake, a reporter for *Education Daily* and *Vocational Training News*, regarding institutions' use of the scholarship funds as revenue for purposes of calculating the 85 Percent Rule; Mr. Kerrigan stated:

*"As long as it wasn't a sham situation, we said they could do this. We shouldn't have said that. At the very least, it was a misunderstanding; at the very worst, it was a mistake. It certainly was a poor choice of words."*

Whether or not ED now considers its prior statement to have been a misunderstanding, mistake or poor choice of words; CCI relied in good faith on that guidance in developing its methodologies and calculating its 85 Percent Rule for each audit period. And as recently as May 20, 1999, Mr. Kerrigan has stated that institutions were allowed to do so. A copy of both the *Education Daily* and *Vocational Training News* articles are attached as Exhibits E-1 and 2.

Therefore, CCI maintains that it has accurately and correctly calculated and reported institutional scholarships as revenue under the 85 Percent Rule and requests that this issue be closed without further action on the part of its Institutions.

- *Institutional matching contributions included in CCI's calculations did not represent non-Title IV cash received.*

#### CCI'S RESPONSE:

CCI disagrees with the OIG that it should not include the 25% institutional matching expense contribution for FSEOG as non-Title IV revenues. CCI applied the entire FSEOG disbursement to student ledgers, which consists of 75% Title IV funds and 25% non-Title IV funds, thereby representing *payment* to the student's account. The Regulations require institutions to maintain FSEOG accounts and to make disbursements at the point at which a student account is credited See 34 CFR Section 676.16. The crediting of the student's account for payment should be treated the same for "cash" as it is for Title IV. The fact that CCI's institutions did not pay the institutional match to each and every student individually does not reduce that institution's revenue.

The Institutions cited in the OIG's audit report are on the Reimbursement payment method. The Regulations regarding reimbursement are clear regarding when funds are considered paid. Section 668.162(d)(1) states: "*Under the reimbursement payment method-*

- (1) *An institution must first make disbursements to students and parents for the amount of funds those students and parents are eligible to receive under the Federal Pell Grant, Direct Loan, and campus-based programs before the institution may seek reimbursement from the Secretary for those disbursements. The Secretary considers an institution to have made a disbursement if the institution has either credited the student's account or paid a student or parent directly with its own funds."*

The fact that the Institution, under the requirements of federal regulations, must consider funds paid upon credit of student accounts, dictates the funds be considered as revenue.

This issue is addressed further in the Independent Certified Public Accountant's position letter enclosed as Exhibit C.

Moreover, the preamble to the April 29, 1994, final regulations state: "[a]n institution should not include institutional matching funds in the numerator as part of its Title IV HEA program funds." See 59 FR 22324, 22327 (April 29, 1994). Therefore, the institutional matching contributions can and must be included in the denominator.

For the reasons stated, the CCI requests this issue be closed without further action on the part of its Institutions.

- *Accrued Pell Grant and FSEOG amounts included in CCI's calculations did not represent Title IV cash received during the fiscal year.*

**CCI'S RESPONSE:**

CCI disagrees with the OIG's assertion that it "improperly included the accrued amount of Pell Grant and FSEOG revenues as Title IV funds instead of actual receipt of reimbursed funds from the Department."

The Institutions cited in the OIG's audit reports are on the Reimbursement payment method. The Regulations regarding reimbursement are clear regarding when funds are considered paid. Section 668.162(d)(1) states "*Under the reimbursement payment method-*

- (1) *An institution must first make disbursements to students and parents for the amount of funds those students amusements are eligible to receive under the Federal Pell Grant, Direct Loan, and campus-based programs before the institution may seek reimbursement from the Secretary for those disbursements. The Secretary considers an institution to have made a disbursement if the institution has either credited the student's account or paid a student or parent directly with its own funds.*

The fact that the Institutions cited in the OIG's audit reports, under the requirements of federal regulations, must consider funds paid upon credit of student accounts, dictates the funds be considered as revenue. Furthermore, as further detailed in the position letter of the independent Certified Public Accountant enclosed as Exhibit C, these Institutions have "constructive receipt" of such funds. Constructive receipt is a cash basis concept used by the Internal Revenue Service in defining when the cash revenues must be included.

CCI requests that this issue be closed without further action on the part of its Institutions.

*Recommendations*

**CCI's RESPONSE:**

CCI believes it correctly calculated and reported its Institutions' 85 Percent Rule for both of the audit years detailed in this report.

The methodologies used to calculate the 85 Percent Rule were and are accurate based on the regulatory policy guidance given by ED to the industry during the years challenged by the OIG.

During this same period the OIG published two sets of revisions to the Audit Guide. The first revision in June of 1995, indicated that institutions were to follow the guidance provided by the Department when calculating its Title IV aid percentage and that this percentage was to be attested to by an independent certified public accountant. The second revision in June of 1997, required institutions to report their 85 Percent Rule compliance in their audited financial statements. This revision required the independent certified public accountant to include the outcome of the test of

the 85 Percent Rule in the audit *opinion* expressed in the audited financial statements, rather than as a separate attestation. That second revision also stated that, “The calculation must be made on a cash basis and in accordance with 34 CFR 600.5.” No guidance as to the OIG's interpretation of “cash basis”, particularly as related to institutional loans, scholarships and FSEOG matches, was provided at that time, even though the Inspector General’s early 1997 statement to Congress indicated that the OIG believed ED had failed to provide consistent and correct guidance on the 85 Percent Rule.

In May of this year (four years after the regulations implementing the 85 Percent Rule went into effect and two years after the OIG stated generally that cash basis accounting was to be used), the OIG published a “Dear CPA Letter” containing specific definitions on its interpretation of what constitutes “revenue” under cash basis accounting and attempted to retroactively apply these definitions to all prior audit periods.

CCI strongly disagrees with the OIG’s assertion that this is the only reasonable conclusion that can be drawn under GAAP cash basis accounting. Furthermore, CCI does not agree that this is not retroactive implementation of these definitions that were published the same month in which the draft copy of this audit report was received by the Institution.

An independent certified public accountant who audited the Institution’s calculations has issued an opinion which upheld our methodology that was developed with the guidance provided by ED. This demonstrates that the OIG's interpretation is not the only acceptable, reliable, substantiated methodology under GAAP Accounting.

The OIG’s interpretation clearly falls outside of the period reviewed in this audit report and must not be applied in this instance. The guidance and definitions promoted in the “Dear CPA Letter”:

- were not, and still have not been, officially presented to the institutions that are being cited for non-compliance;
- have not been promulgated in final regulations by the Secretary who is responsible for setting regulatory policy; and
- can not be applied to audit periods that ended almost a full year before the interpretation, and its corresponding definitions, were published.

The courts have ruled that retroactive implementation of new rules is unjust. We hope that the OIG will heed the principle acknowledged by the Supreme Court in *Heckler v. Community Health Services of Crawford County, Inc.* and will refrain from attempting to enforce its new definitions on audit periods already completed.

This having been said, if the OIG seeks to implement its interpretation prospectively, CCI will closely monitor the decisions of ED, and if ED should officially embrace the OIG’s interpretation and their new definitions, CCI will modify its methodologies to ensure that all of its institutions adhere to the regulatory policy changes. Specifically, if the Secretary’s Final Regulations implementing the Higher Education Act Amendments of 1998, like the proposed regulations in the NPRM issued on July 15, 1999, include the changes outlined in the “Dear CPA Letter”, CCI will make sure that it is in compliance with the revised regulatory policy by the July 1, 2000, effective date.

Nonetheless, while CCI does not agree with the OIG's recently announced interpretation and its definitions stated in this report, CCI performed 90 Percent Rule calculations for both Institutions for fiscal year 1999 using both the OIG's interpretation and the Institution's methodology. CCI's independent certified public accountant has issued an attestation of those calculations using both methodologies. A copy of the attestations are enclosed as Exhibit F.

As the charts below indicate, using either methodology, both Mountain West College and Las Vegas College have percentages below the eligibility threshold required by law and in the regulations for the most recent audit period.

**Mountain West College's 90/10 Calculation  
Fiscal Year 1999**

	OIG's Interpretation	CCI's Interpretation
Total Funds	\$2,982,607	\$2,991,886
Title IV Funds	\$2,503,337	\$2,521,953
Title IV Percentage	83.93%	84.29%

**Las Vegas College's 90/10 Calculation  
Fiscal Year 1999**

	OIG's Interpretation	CCI's Interpretation
Total Funds	\$2,114,467	\$2,099,132
Title IV Funds	\$1,760,431	\$1,756,668
Title IV Percentage	83.26%	83.69%

In summation, during the audit years at issue in this report, CCI used the guidance provided by ED, which was consistent with other resources, to develop its methodologies under the 85 Percent Rule and acted accordingly. Had the guidance provided in the OIG's interpretation and its new definitions been published during the reporting periods in question, at the very least we would have sought additional guidance from ED as to whether or not these interpretations were consistent with ED's regulatory policy and we would have acted accordingly.

In spite of the Inspector General's expression of concern in early 1997 to a Congressional Subcommittee about the correctness of ED's policy guidance on the 85 Percent Rule, the OIG did not publish any policy guidance for the industry. Furthermore, the OIG's interpretation was not publicized during the audit periods under review in this report and was not even provided as informal guidance by ED, who is responsible for setting regulatory policy. In fact, ED provided written responses that are in direct conflict with the interpretations now being employed by the OIG. CCI, after reviewing the pronouncements of both organizations and other sources, calculated its 85 Institution's Percent Rule compliance using the regulatory policy guidance provided by ED. The OIG cannot now nullify the Institution's compliance through retroactive application of a new rule. Accordingly, the OIG's findings of non-compliance should be rescinded and this matter should be closed with no further action being required by CCI on the part of its Institutions.

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