
HALLMARK INSTITUTE OF AERONAUTICS' COMPLIANCE WITH THE 85 PERCENT RULE

FINAL AUDIT REPORT



Control Number ED-OIG/A06-80013

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

MAR 6 2000

THE INSPECTOR GENERAL

Audit Control Number ED-OIG/A06-80013

Mr. Richard Fessler, Owner
Hallmark Institute of Aeronautics
10401 IH 10 West
San Antonio, Texas 78230

Dear Mr. Fessler:

This is our audit report, *Hallmark Institute of Aeronautics' 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 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,

A handwritten signature in cursive script that reads "Lorraine Lewis".

Lorraine Lewis

Attachment

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EXECUTIVE SUMMARY

Hallmark Institute of Aeronautics (Hallmark Institute), a proprietary school located in San Antonio, Texas, did not qualify as an eligible institution for participation in the Title IV, Student Financial Assistance programs. We estimate Hallmark Institute received at least 86.73 and 87.56 percent of its revenue from Title IV sources during its fiscal years ending December 31, 1996 and 1997, respectively. As a result, Hallmark Institute was not eligible to participate in the Title IV programs as of January 1, 1997. From January 1, 1997 through December 31, 1998, Hallmark Institute received \$2,470,312 in Federal Pell Grants and Federal Supplemental Education Opportunity Grants (SEOG) and \$2,734,274 in Federal Family Education Loan Program (FFELP) funds.

Under the Higher Education Act in effect during the audit period, 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. Hallmark Institute reported that it met the 85 Percent Rule in the notes to its fiscal year 1996 and 1997 financial statements. However, Hallmark Institute did not meet the 85 Percent Rule because its calculations for both fiscal years improperly included, as non-Title IV revenue, SEOG and Federal Perkins Loan Program (Perkins) matching contributions, tuition waivers, Title IV revenue misclassified as non-Title IV revenue, and non-tuition or fee related revenue.

We recommend that the Chief Operating Officer for Student Financial Assistance take action to terminate Hallmark Institute from participation in the Title IV programs unless Hallmark Institute can demonstrate that it met eligibility requirements for its fiscal year ended December 31, 1998. The Chief Operating Officer should also require that Hallmark Institute return to the Department or lenders \$2,470,312 of Pell Grant and SEOG funds and \$2,734,274 of FFELP funds received after the school became an ineligible institution. The amounts apply to the period from January 1, 1997 to December 31, 1998.

Hallmark Institute did not agree with our findings and recommendations. As a result of Hallmark Institute's response to our draft report, we performed additional work at the school. Based on the school's response and the additional work performed, we have not changed our findings and recommendations. We paraphrased the school's comments and provided additional OIG comments after the Recommendations section of this report. A copy of the school's response is included as an Appendix to the report. Copies of exhibits that were included with the response are available on request.

AUDIT RESULTS

We concluded that Hallmark Institute had not derived 15 percent of its revenues from non-Title IV sources during the fiscal years ending December 31, 1996 and 1997 and was not eligible to participate in the Title IV programs as of January 1, 1997. Hallmark Institute received \$2,470,312 in Pell Grant and SEOG funds and \$2,734,274 of FFELP funds from January 1, 1997 to December 31, 1998.

Hallmark Institute reported that it received 84.35 percent of total revenue from Title IV sources in its 1996 financial statements. We estimate that Hallmark Institute received at least 86.73 percent of total revenue from Title IV sources. The amounts that Hallmark Institute used in its 1996 calculation improperly included \$40,670 of SEOG and Perkins institutional matching funds, \$31,000 for tuition waivers classified as institutional scholarships, at least \$6,132 in misclassified Title IV revenue, and at least \$3,027 that was not related to tuition and fees or other institutional charges.

For fiscal year 1997, Hallmark Institute reported that it received 83.28 percent of total revenue from Title IV sources. We estimate that Hallmark Institute received at least 87.56 percent of total revenue from Title IV sources. The amounts that Hallmark Institute used in its 1997 calculation incorrectly included \$38,600 of SEOG and Perkins institutional matching funds and at least \$149,606 in Title IV revenue misclassified as non-Title revenue.

Proprietary Schools Are Required To Generate At Least 15 Percent Of Revenue From Non-Title IV Funds

Section 481(b) of the Higher Education Act (HEA), in effect during the audit period, stated: *...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 referred to as the 85 Percent Rule. The regulations also provide the 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. The formula is as follows:

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.

***SEOG/Perkins
Matching Funds
Inappropriately
Included In The
Calculation***

In both its 1996 and 1997 calculations, Hallmark Institute included its SEOG and Perkins matching contributions as non-Title IV revenue. The transactions did not represent an inflow of cash to the institution because they neither increased the institution's assets nor decreased its liabilities. In 1996, Hallmark Institute included \$13,181 in SEOG and \$27,489 in Perkins matching funds as non-Title IV revenue. In 1997, the amounts of SEOG and Perkins matching funds included as non-Title IV revenue were \$20,951 and \$17,649, respectively. We removed the amounts from the denominator for the respective years as shown in Tables 1 and 2.

***Tuition Waivers
Inappropriately
Included In The
Calculation***

In its 1996 calculation, Hallmark Institute included tuition waivers classified as institutional scholarships and non-Title IV revenue. The tuition waivers did not represent an inflow of cash revenue to the institution. The tuition waivers recorded by the school represented a non-cash accounting entry that reduced the amount owed by students for tuition and fees. Hallmark Institute's calculation included \$31,000 in non-Title IV tuition waivers that it classified as institutional scholarships and non-Title IV revenue. We reduced the denominator by the amount of the scholarships as shown in Table 1. Hallmark Institute did not use tuition waivers in 1997.

***Title IV Funds
Misclassified As Non-
Title IV Revenues***

Our review of the 1996 and 1997 calculations disclosed that Hallmark Institute misclassified Title IV transactions as non-Title IV revenue. For example, the school provided a Federal PLUS Program (PLUS) loan check for \$1,786 to the borrower who endorsed the check and returned it to the school. The school accepted the check as payment for the student's tuition and classified the \$1,786 as non-Title IV tuition revenue. A total of \$6,132 was misclassified in this manner in 1996 and \$128,391 in 1997.

In the 1997 calculation, Hallmark Institute also changed the identity of an additional \$21,215 from Title IV revenue to non-Title IV revenue. As an example, a student paid cash of \$150 and Hallmark Institute received Pell Grant funds of \$2,428 and FFELP loan funds of \$6,360 for the student. Hallmark applied the funds toward charges for tuition, fees, and books during the academic year. At the end of the academic year, the student's account showed a credit balance of \$148. Hallmark Institute disbursed \$1,360 to the student using a school check and created a debit balance of \$1,211 in the student's account. Hallmark Institute reduced its Title IV tuition revenue by \$1,360. Two weeks later, the student provided Hallmark Institute with a check for \$1,360 or the exact amount of the original disbursement to the student. Hallmark Institute applied the \$1,360 to the student's account and then classified it as non-Title IV revenue. A total of \$21,215 was misclassified in this manner in 1997.

Hallmark Institute posted a total of at least \$6,132 and \$149,606 (\$128,391 + \$21,215) in error as non-Title IV revenue in 1996 and 1997 respectively. We adjusted the numerator and denominator for these transactions as shown in Tables 1 and 2.

***Non-Tuition Revenue
Included As Non-Title
IV Revenue***

In its 1996 calculation, Hallmark Institute included \$3,027 as revenue that was not for tuition, fees, or other institutional charges. The revenues included in the 85 Percent Rule calculation are limited to revenues generated by the institution from: Tuition, fees, and other institutional charges [34 CFR 600.5 (d)(1)]. For example, Hallmark Institute received \$1,734 for an insurance premium reimbursement and included the funds as tuition revenue. We reduced the denominator by \$3,027 as shown in Table 1.

Table 1
Hallmark Institute's and OIG Calculated Percentage of Title IV Revenue
January 1, 1996 to December 31, 1996.

Funding Source	Hallmark Institute's Calculation *	SEOG Match	Perkins Match	Tuition Waivers	Misclassified Title IV Funds	Non-Institutional Charges	OIG's Estimate
Title IV Receipts	\$2,517,478				\$6,132		\$2,523,610
Non-Title IV Receipts	\$ 466,985	(\$13,181)	(\$27,489)	(\$31,000) ¹	(\$6,132)	(\$3,027)	\$386,156
Total Revenue (Cash Basis)	\$2,984,463	(\$13,181)	(\$27,489)	(\$31,000)		(\$3,027)	\$2,909,766
Title IV Funds as a Percent of Total Revenue	84.35%						86.73%

*Hallmark Institute's calculation included the Title IV Receipts and Total Revenue. The Non-Title IV Receipts is a mathematical calculation made by the OIG.

Table 1 above illustrates that Title IV revenues represented 86.73 percent of total revenue rather than the 84.35 percent reported by Hallmark Institute for the fiscal year ending December 31, 1996. 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, Hallmark Institute was not eligible to participate as of January 1, 1997.

Table 2 shows that Title IV revenues represented 87.56 percent of total revenue and not the reported 83.28 percent for Hallmark Institute's fiscal year ending December 31, 1997.

¹ Subsequent to issuing our draft report, the Department of Education has stated that: ... *absent unusual circumstances, [it] does not intend to exercise its enforcement authority against institutions that count these loans and scholarships as revenue solely on the grounds that the loans and scholarships fail to comply with cash basis accounting requirements.* We determined that the institutional scholarships were valid. However, even if these non-cash, institutional scholarships were included as 1996 revenue, Hallmark Institute would still not meet the institutional eligibility requirement with a score of 85.81 percent.

Table 2
Hallmark Institute's and OIG Calculated Percentage of Title IV Revenue
January 1, 1997 to December 31, 1997

Funding Source	Hallmark Institute's Calculation *	SEOG Match	Perkins Match	Misclassified Title IV Funds	OIG's Estimate
Title IV Receipts	\$3,571,602			\$149,606	\$3,721,208
Non-Title IV Receipts	\$717,062	(\$20,951)	(\$17,649)	(\$149,606)	\$ 528,856
Total Revenue (Cash Basis)	\$4,288,664	(\$20,951)	(\$17,649)		\$4,250,064
Title IV Funds as a Percent of Total Revenue	83.28%				87.56%

*Hallmark Institute's calculation included the Title IV Receipts and Total Revenue. The Non-Title IV Receipts are a mathematical calculation made by the OIG. Hallmark Institute did not use tuition waivers in 1997.

RECOMMENDATIONS

We recommend that the Chief Operating Officer for Student Financial Assistance:

1. Take action to terminate the participation of Hallmark Institute in Title IV programs unless Hallmark Institute can demonstrate that it met eligibility requirements for its fiscal year ended December 31, 1998.
2. Require that Hallmark Institute return to the Department \$2,470,312 of Federal Pell Grant and Federal SEOG funds received during January 1, 1997 through December 31, 1998.
3. Require Hallmark Institute to return to lenders \$2,734,274 of FFELP funds received during January 1, 1997 through December 31, 1998. This amount does not include loan origination fees, interest, or special allowance costs incurred by the Department for the loans.

HALLMARK INSTITUTE'S COMMENTS TO DRAFT REPORT

Hallmark Institute disagreed with our conclusion that the institution did not comply with the 85 Percent Rule for fiscal years ending December 31, 1996 and 1997. A copy of the letter from Hallmark Institute is included as an Appendix to this report. Exhibits that were included with the letter are available on request.

Hallmark Institute contended that it made its calculations in good faith and that the school would have been in compliance with the 90 Percent Rule for fiscal years 1996, 1997, 1998. Hallmark Institute disagreed that \$6,132 and \$149,606 had been misclassified as non-Title IV revenues for the FY 1996 and FY 1997 calculations respectively. Hallmark Institute agreed that most of these funds were originally PLUS loans and credit balances that subsequently lost their identity. *At some later time, that same or similar sum that was disbursed to the borrower was paid to the school by the borrower or student with checks from personal accounts, such as credit unions and banks, for the students' tuition, fees or institutional charges. ...The fact that these funds match up with the PLUS loan disbursement does not render the funds Title IV revenue. In fact, it is impossible to tell what character the funds are made up of after they have been deposited into personal accounts and commingled with other funds.*

Hallmark Institute also argued that it offered a valid scholarship program and had properly included institutional scholarships in the calculation. Hallmark Institute also submitted that it should have included as non-Title IV revenue, significant amounts of institutional loans made to students but not paid back during the fiscal year. *A review of Hallmark's institutional loans reveals that about \$353,001 and \$259,151 were paid out to students in FY 1996 and FY 1997, respectively. ...about \$202,515 and about \$64,462 in FY 1996 and FY 1997, respectively, represent the amounts made in those fiscal years that were not counted in the denominator.*

Hallmark submits that the amounts that were not treated as revenue should also be counted as non-Title IV revenue in the fiscal years in which the loans were made.

OIG RESPONSE TO COMMENTS

Hallmark Institute's comments did not persuade us to change our findings or recommendations.

Regarding Hallmark Institute's assertion that PLUS loan funds lost their identity when deposited in borrower accounts, the regulations state: *...With regard to the numerator, any title IV, HEA program funds disbursed or delivered to or on behalf of a student shall be presumed to be used to pay the student's tuition, fees, or other institutional charges, regardless of whether the institution credits those funds to the student's account or pays those funds directly to the student...* [34 CFR 600.5(d)(2)(v)].

We returned to the school to verify the school's claim that it had found additional revenue in the form of unpaid institutional loans. We reviewed 28 files for students that Hallmark Institute claimed had an institutional loan. The regulations provide 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* [34 CFR 600.5 (d)(2)(i)]. The regulations stipulate that the revenue to include in the denominator is the sum of revenues generated by the institution from tuition, fees, and other institutional charges. Only those amounts from institutional loans that are applied to tuition, fees and other institutional charges may be included in the calculation. We determined that none of the amounts claimed by Hallmark Institute as additional loan principal were applied to student accounts for tuition, fees, and other institutional charges. We allowed all amounts from the "institutional loans" applied against tuition, fees and other institutional charges as non-Title IV revenue in our calculation during the audit.

We verified that Hallmark Institute had a valid scholarship or tuition waiver selection process. Since issuing our draft report, the Department has stated that: *...absent unusual circumstances, [it] does not intend to exercise its enforcement authority against institutions that count these loans and scholarships as revenue solely on the grounds that the loans and scholarships fail to comply with cash basis accounting requirements* [GEN - 99-33]. After adding the institutional scholarships back for the 1996 calculation, Hallmark Institute still failed to meet the institutional eligibility requirement with a score of 85.81 percent. The scholarship or tuition waiver amounts claimed by Hallmark Institute will not count as revenue for the calculation for audits submitted to the Department after June 30, 2000.

BACKGROUND

Hallmark Institute of Aeronautics is a proprietary institution located in San Antonio, Texas. Hallmark Institute received initial approval to participate in Title IV programs in March 1985 and is accredited by the Accrediting Commission of Career Schools and Colleges of Technology. The institution offers a variety of programs including Aviation Technology, Airframe Technology, Electronics Technology, and Office Management.

During the period January 1, 1996 through December 31, 1998, Hallmark Institute received \$7,728,198 of Federal Pell Grant, Federal Supplemental Educational Opportunity Grant, and Federal Family Education Loan Program funds.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our audit was to determine whether Hallmark Institute derived at least 15 percent of its revenues from non-Title IV sources and properly reported its 85 Percent Rule percentage.

To accomplish our objective, we obtained background information about the institution. We reviewed selected Hallmark Institute student files and Department records. We reviewed Hallmark Institute's fiscal year 1996 and 1997 audited financial statements and Title IV compliance audit reports. We also conducted interviews with Hallmark Institute officials and staff.

We performed an analysis of and used information extracted from Hallmark Institute's student account ledgers, which are maintained on a computerized database. We tested the reliability of the computerized information by verifying that amounts agreed with amounts from other sources such as institutional bank statements and student records. We concluded that the computerized information was sufficiently reliable for the purposes of our audit. We also used data applicable to the school that we obtained from the Department's National Student Loan Data System and Postsecondary Education Participants System.

Our audit covered Hallmark Institute's fiscal years ending December 31, 1996 and 1997. We performed fieldwork at Hallmark Institute from October 5, 1998 through October 21, 1998. We revisited the school on September 7, 1999 to evaluate elements of Hallmark Institute's response to our draft report. 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 Hallmark Institute's management control structure, as well as its policies, procedures, and practices applicable to the scope of the audit. For the purpose of this report, we assessed management controls related to Hallmark Institute's calculation and reporting of the percentage of revenues received 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 percentage. The weaknesses are discussed in the Audit Results section of this report.

APPENDIX I

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July 30, 1999

**VIA FACSIMILE (214 880-2492)
AND OVERNIGHT MAIL**

Mr. Daniel J. Thaens
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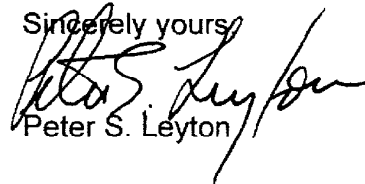
Re: Hallmark Institute of Aeronautics – Response to Draft Audit

Dear Mr. Thaens:

As you know, this Firm represents Hallmark Institute of Aeronautics. Please find attached Hallmark's written comments and response, with exhibits, to the draft Office of Inspector General Report (ACN 06-80013). In this connection, we appreciate your courtesy in providing Hallmark with an extension of time in which to respond and with the opportunity to file these comments.

If you have any questions, please feel free to contact me.

Sincerely yours,



Peter S. Leyton

PSL/
Enclosure

fc: Mr. Richard H. Fessler

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APPENDIX I

EXHIBIT LIST

1. OIG Draft Audit
2. Fiscal Year 1996 Financial Statements
3. Fiscal Year 1997 Financial Statements
4. Fiscal Year 1998 Financial Statements
5. Declaration Of Richard H. Fessler
6. Federal Register, dated February 10, 1994
7. Federal Register, dated April 29, 1994
8. Opinion Letter of Salmon, Beach & Company, P.C. with Attachments
9. Notice of Proposed Rulemaking, dated July 15, 1999
10. Letter from Sharon Bob to Cheryl Leibovitz, dated May 13, 1994
11. Letter from David Steiner to Cheryl Leibovitz, dated April 4, 1996
12. Letter from Chris Tostenrud to Peter S. Leyton, dated June 1, 1999
13. Excerpt from Education Daily, dated May 21, 1999
14. Decisions in the Matters of Blair Junior College and Nettleton Junior College
15. OIG SFA Action Memorandum No. 99-07, dated January 8, 1999
16. OIG Dear CPA Letter, CPA-99-01, dated April 26, 1999
17. American Council On Education Letter to Secretary Riley, dated June 30, 1999
18. The Hallmark Institutes Scholarship Criteria
19. Ledger Cards for Jaime Flores and Jared Baker
20. Student Ledger Cards Regarding Credit Balances
21. Declaration of Vanessa Kenon
22. Declaration of Nancy Broff with Attachments

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- 23. Correspondence Regarding Alamo Workforce Development Council, Inc.
- 24. Hallmark Promissory Notes
- 25. Example of Hallmark Student Financial Aid Record

**HALLMARK INSTITUTE OF AERONAUTICS'S
RESPONSE TO THE OFFICE OF INSPECTOR
GENERAL'S DRAFT AUDIT REPORT
ACN 06-80013**

I.
PRELIMINARY STATEMENT

On May 26, 1999, the U.S. Department of Education Office of Inspector General ("OIG") issued a draft audit report to Hallmark Institute of Aeronautics ("Hallmark"), Audit Control Number 06-80013 ("Draft Audit", *Exhibit 1*). The Draft Audit focused solely upon Hallmark's compliance with what is commonly referred to as the 85 Percent Rule.¹

The Draft Audit concluded that the percentage of Hallmark's non-Title IV revenue for fiscal years 1996 and 1997 did not achieve the minimum non-Title IV revenue threshold of 15 percent.² Hallmark's audited financial statements, prepared by Salmon, Beach & Company, P.C. ("SBC"), reported the Institution's Title IV revenue percentages for fiscal years 1996 and 1997 as 84.35% and 83.28%, respectively. *Exhibit 1 at 2, Exhibit 2, note 8 and Exhibit 3, note 8.*

The differences between the calculations of the OIG and SBC are the result of differing interpretations of what constitutes revenue that can be included in the denominator of the fraction. The principal issues concern the exclusion by the OIG of SEOG and Perkins matching funds and the reclassification of cash revenue as Title IV revenue. *Exhibit 1 at 3-4.*

The OIG recommends that the Office of Student Financial Assistance ("OSFA") take an action to terminate Hallmark's participation in the Title IV programs unless it can demonstrate that it met the 90 Percent Rule for fiscal year 1998. The OIG also recommends that OSFA require Hallmark to return about \$5.2 million in combined Title IV grants and loans disbursed during fiscal years 1997 and 1998. *Exhibit 1 at 6.*

Hallmark received 86.54% of its revenue from Title IV in fiscal year 1998. *Exhibit 4, note 7.* This is well within the 90 Percent Rule limitation. Hallmark

¹ Under the 85 Percent Rule, at least 15 percent of a proprietary school's revenue had to be derived from non-Title IV sources. 20 U.S.C. § 1088(b)(6)(section 481(b)(6) of the HEA) and 34 C.F.R. § 600.5(a)(8). On October 7, 1998, the HEA was reauthorized as part of which this provision was amended to require that at least 10 percent of a proprietary school's revenue has to be derived from non-Title IV sources. Section 102 of the Higher Education Amendments of 1998. The Department has not issued any formal guidance with respect to the effective date of this provision, however, it has informally advised the affected community that the 10 percent rule is effective with respect to any fiscal year ending on or after October 7, 1998.

²The Institute's Title IV revenue percentages for FY 1996 and FY 1997, according to the Draft Audit, are 86.73% and 87.56%, respectively. *Exhibit 1 at 2.*

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correctly calculated its Title IV and non-Title IV revenue and was in compliance with the 85 Percent Rule for both fiscal years 1996 and 1997³

For these and other reasons advanced below, Hallmark submits that its interpretations of law and fact were not only accurate but were made in good faith reliance on the limited guidance from the Department and its accountants. As such, the OIG conclusions and recommendations are unfounded and inappropriate.

II. **BACKGROUND**

Hallmark was founded in January 1969 as a Federal Aviation Administration Certificated School. See *Exhibit 5, Declaration of Richard Fessler*. The Institute has been accredited since 1971. Richard H. Fessler is the Institute's president and co-founder. The Institute is a participating institution of higher education located in San Antonio, Texas.

Hallmark offers associate degree programs as well as non-degree vocational programs designed to prepare individuals for gainful employment in recognized occupations in aviation. *Exhibit 5, ¶ 6*. The programs are regulated and approved by the Federal Aviation Administration and/or the Texas Higher Education Coordinating Board and not the Texas Education Agency.

There are presently about 480 students enrolled in programs at the affected School and about 115 people employed as faculty and staff including the management. *Exhibit 5, ¶ 7*.

III. **THE 85 PERCENT RULE**

The 85 Percent Rule was enacted in 1992. It provided that proprietary institutions of higher education must derive "at least 15 percent" of their revenues from non-Title IV sources. Section 481(b)(6) of the HEA.

According to the Secretary, the principal purpose of the law "... is to require proprietary institutions to attract students based on the quality of their programs, not solely because the institutions offer Federal student financial assistance. Thus, under the statute, these institutions must attract students who will pay for their programs with funds other than Title IV, HEA program funds." *Exhibit 6, 59 Fed. Reg. 6446, 6448 (Feb. 10, 1994)*(emphasis added).

³ And, even assuming it was not in compliance for FY 1996, its maximum liability exposure would be the one year, FY 1997, since it would have been able to return to Title IV participation in FY 1998 following the 1997 hiatus. 34 C.F.R. § 600.5(g).

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Final regulations were promulgated on April 29, 1994. *Exhibit 7*. Congress, however, delayed their effective date to July 1, 1995. Pub.L.103-333; see 34 C.F.R. § 600.5(a)(8). The regulations require all proprietary institutions to disclose the percentage of their revenue derived from Title IV, HEA programs, as defined at section 600.5(d), in a footnote to their annual audited financial statements. 34 C.F.R. § 668.23(d)(4).

The Secretary requires a proprietary institution to determine the percentage of its revenue from Title IV and non-Title IV sources by dividing the amount of Title IV funds the institution used to satisfy tuition, fees and other institutional charges by 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. See 34 C.F.R. § 600.5(d)(1).

IV.

HALLMARK IS IN COMPLIANCE WITH THE 90 PERCENT RULE

Hallmark's 90/10 calculation for fiscal year 1998 is 86.54%. *Exhibit 4 at note 7*. This calculation was audited by SBC and was made in accordance with all known OIG interpretations governing cash basis accounting. Hallmark's fiscal year 1997 and 1996 calculations are also in compliance with the 90 Percent Rule based on the OIG calculations in the Draft Audit. *Exhibit 1 at 5*. While the 90 Percent Rule was not in effect for those years, Hallmark submits that the fact that it met the new Rule in those years is a relevant consideration especially since Congress clearly considers the 85 Percent Rule to have been too restrictive.

V.

HALLMARK'S TREATMENT OF MATCHING FUNDS WAS CORRECT

The OIG states that Hallmark improperly included \$13,181 in SEOG and \$27,489 in Perkins matching funds as non-Title IV revenue in FY 1996 and \$20,951 and \$17,649 in SEOG and Perkins matching funds, respectively, as non-Title IV revenue in FY 1997. Hallmark's treatment of these funds as non-Title IV revenue in the denominator of the fraction was proper.

For example, in the preamble to the final regulations, a commenter said that

"institutional portions of programs, such as the Federal SEOG and Federal Perkins programs, should not be included in the numerator since the money comes from the institution and not the Federal Government." *Exhibit 7 at 22327*.

In response, the Secretary said

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"The Secretary **agrees**. An institution should not include institutional matching funds in the numerator as part of its title IV, HEA funds."
Id.

The Secretary clearly agreed that the matching funds are "money" from the school and also clearly limited the exclusion to the numerator! Hallmark and its accountants reasonably and properly interpreted this language to mean that matching funds could be included in the denominator of the fraction.

VI. HALLMARK PROPERLY INCLUDED INSTITUTIONAL SCHOLARSHIPS IN THE CALCULATION

For the same reason that the OIG excluded matching funds, since it does not consider the funds to represent an inflow of cash revenue to the school, the OIG excluded \$31,000 in institutional scholarships that Hallmark awarded in FY 1996.

Hallmark included institutional scholarships as revenue received in the calculation of the 85 Percent Rule for FY 1996 in reliance on all available guidance from the Department. *Exhibit 5, ¶ 10*. Specifically, the preamble to the final 1994 regulations states that

"an institution is not prohibited from including institutional charges that were paid by institutional scholarships and institutional loans as revenue in the denominator of the fraction...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." 59 Fed. Reg. 22324 (April 29, 1994), *Exhibit 7*.

As can be seen from this quote, institutional scholarships are clearly authorized. The sole focus of the Secretary's comment is on the question of whether the scholarship is a "valid" program "and not just part of a scheme to artificially inflate" tuition and fee charges. Numerous institutions and their accountants including Hallmark's interpreted this specific language to permit proprietary institutions to establish institutional scholarship programs that did not incorporate new or external funding sources. *Exhibit 5 & 8*.

Nowhere in the preamble or the regulation is the term "revenue" defined and nowhere is it made clear to institutions that the Secretary might have meant an inflow of revenue or cash from a source external to the institution. Certainly, if this is what the Secretary meant, he could have easily said it at the time. Only now has the Secretary proposed regulations to eliminate any "ambiguity." *Exhibit 9* at 38276, July 15, 1999 Notice of Proposed Rulemaking.

In fact, the 1994 preamble supports just the opposite interpretation as discussed above in the context of matching funds. The character of matching

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funds is no different than the character of the institutional scholarship funds. That is, both are derived from the institution and not from any new or external source.

Likewise, the Department's guidance on the treatment of institutional loans is also consistent with this interpretation. The issue concerns the inclusion of institutional loans in the year when the loans are made rather than when the payments are received by the institution. The Secretary's only comment in this regard was that evidence of repayment on loans was necessary in order to demonstrate that the loans were "real". *Exhibit 7 at ¶22328.*

Consistently, the Department said that the institution could include the full amount of the loan when made in the denominator. *Exhibits 10-12.* As with scholarships, the institutional loans do not reflect actual cash inflows yet the Department has expressly permitted their inclusion in the 85 percent calculation.

Clearly, Hallmark's reliance on available Departmental guidance was appropriate, reasonable and in good faith. In fact, Departmental officials have acknowledged that the affected community of proprietary schools legitimately interpreted the available guidance to mean that "as long as it wasn't a sham situation" they could use institutional scholarships in the manner followed by Hallmark. *See Exhibit 13, Statement of Brian Kerrigan as reported by Education Daily, May 21, 1999.* Mr. Kerrigan further stated that the choice of words (that is, the Secretary's in the preamble to the final regulations) was either a "misunderstanding" or "mistake."

Regardless of whether it was a misunderstanding or a mistake, Hallmark's reliance on the guidance and available representations was appropriate and reasonable. It also established a "safe harbor" for Hallmark from a claim for monies or an administrative action. As noted by Administrative Law Judge Cross in *Blair Junior College, below,*

"ED has established a so-called 'safe harbor' for past actions. If a school fully acts in the manner instructed by OSFA, there will be no penalty for such past action if OSFA subsequently decides to change a policy direction." *In the Matter of Blair Junior College, Dkt. No. 93-23-SP (June 1, 1994)(Dec. of ALJ Cross) at 27 quoting from Associated Technical College, Dkt. No. 91-112-SP at 27, (Feb. 3, 1993)(Dec. of ALJ Cross), affirmed by the Secretary, July 23, 1993; see also In the Matter of Nettleton Junior College, Dkt. No. 93-29-SP (June 8, 1994)(Dec. of ALJ Cross.) See Exhibit 14.*

As also noted in *Blair and Nettleton*, another authoritative acknowledgement of the 'safe harbor' principle is found in a Declaration filed by Ernest C. Canellos in a lawsuit in the U.S. District Court for the District of Columbia. Mr. Canellos was then Acting Deputy Assistant Secretary for OSFA;

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he is now an administrative law judge with the Department. In the Declaration, Judge Canellos specifically admitted that the Secretary recognized that guidance given by the Department that is relied upon by schools creates a 'safe harbor' from imposition of a penalty that might otherwise be imposed for past action. *Id.*

Even assuming for argument sake that the OIG interpretation is valid, it represents a new direction and policy change that is contrary to past available guidance. This is perhaps best illustrated by the January 1999 OIG SFA Action Memorandum No. 99-07 and the OIG Dear CPA letter sent to CPAs in late April 1999. See *Exhibits 15 & 16*.

The SFA Action Memorandum to Greg Woods was intended as an "alert" by the OIG to the OSFA. Its focus was on serious problems the OIG believed it had identified regarding the manner in which many proprietary schools were calculating the 85 Percent Rule. The memorandum states that, as of that date, the OIG had conducted 20 audits of proprietary schools and found that in 11 of the 20 audits (55%), institutions were including amounts in the calculation that did not represent revenue received. *Id.* The number one reason cited by the OIG for miscalculating the 85 Percent Rule was the inclusion of institutional scholarships.

On April 26, 1999, the OIG released a Dear CPA letter intended to provide practitioners with guidance in performing financial statement audits with particular focus on calculating the 85 Percent Rule and 90 Percent Rule. *Exhibit 16*. In the letter, the OIG states that it has "identified mistakes" in the calculation of the Rule. *Id. at 1*. The very first example of "mistakes" found, again, institutional scholarships being counted as revenue.

The 85 Percent Rule was enacted in 1992. *Section 481(b)(6) of the HEA*. Final regulations were promulgated on April 29, 1994. Congress, however, delayed their effective date to July 1, 1995. *Pub.L.103-333; see 34 C.F.R. § 600.5(a)(8)*. Yet, nearly four years after the effective date of the regulations and five years after the regulations were promulgated, the OIG is identifying "mistakes" by CPAs in the calculation of the 85 Percent Rule that require the issuance of a threatening letter to the CPAs and an "alert" to the OSFA. The fact that "mistakes" are only now being identified is evidence in support of the reasonableness of Hallmark's calculations and reliance on the available Departmental guidance. It also demonstrates why Hallmark is entitled to a safe harbor from penalties imposed because of a new policy direction.

That the OIG interpretation of the meaning of "revenue" in the context of the 85 Percent Rule is a new policy and an attempt to apply a new policy retroactively, in violation of the law, was very recently addressed by the President of the American Council on Education. On June 30, 1999, President Ikenberry wrote Secretary Riley on behalf of the Association of American Universities, Association of Jesuit Colleges and Universities, Council of Independent Colleges,

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National Association of College and University Business Officers, National Association of Independent Colleges and Universities, National Association of State Universities and Land Grant Colleges and National Association of Student Financial Aid Administrators. See *Exhibit 17*. In his letter, he wrote regarding the retroactive interpretations at issue in this appeal and said:

"However, we believe it is a fundamental principle of public policy that published regulations mean exactly what they say until the agency that issues those regulations formally publishes a revision. *Ex post facto* application of revised rules and regulations is not in the best long term interest of anyone, regardless of the specific matter under dispute." *Id.* at 2.

VII. HALLMARK OFFERED A VALID SCHOLARSHIP PROGRAM

Hallmark's scholarship program is based on a set of very specific criteria. *Exhibit 18*. The preamble to the final regulations makes it clear that the Secretary's concern with respect to a scholarship program is if it is part of a scheme to artificially inflate an institution's tuition and fee charges. *Exhibit 7, 59 Fed. Reg. 22324*. With this in mind, it begins to become clear why the Secretary considered a scholarship program in which every student who successfully proceeded to the second year of a program a sham.

Hallmark's very limited program was clearly not part of any scheme to artificially inflate its tuition and fee charges. To qualify for consideration at Hallmark, a student has to have a cumulative 3.25 GPA, successfully completed 12 credit hours and attended 85 percent of scheduled class time. *Exhibit 18 at 1*.

In 1996, Hallmark had about 352 students had in attendance. Of these, 53% or 186 applied for scholarships. *Exhibit 5 at ¶ 15*. Of these, only 31 or 17% received scholarships.

Significantly, these facts clearly demonstrate that Hallmark's scholarship program was a valid program and not part of scheme to artificially inflate tuition and fee charges.

VIII. HALLMARK DID NOT MISCLASSIFY TITLE IV FUNDS AS NON-TITLE IV REVENUE

The Draft Audit excluded \$6,132 and \$149,606 from the FY 1996 and FY 1997 calculations, respectively, on the grounds that the monies were misclassified as non-Title IV revenue. For the two years combined, \$134,523 is attributed by OIG to situations involving PLUS loan checks being endorsed by borrowers and then being returned to the school where the deposits were treated

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as non-Title IV revenue. *Exhibit 1 at 3*. The remaining sum of \$21,215 involves payments of credit balances to students with subsequent payments by students of tuition and fee charges being treated as non-Title IV revenue. *Id. at 4*. The OIG's interpretation is wrong in both respects.

The PLUS loan program is intended to permit parents of dependent students to borrow funds to meet the student's costs of education. 34 C.F.R. § 682.100 (3), § 682.201(b)(1)(i). Costs of education are not limited to tuition, fees and institutional charges. They also include living expenses and other costs necessary to permit the student to attend school. Certainly, PLUS loan checks can be endorsed to the school and used to pay tuition, fees or institutional charges. If this were done, the funds should have been counted as Title IV revenue. This is, however, not what occurred.

Rather, PLUS loan amounts were disbursed to parent borrowers. The borrower deposited the funds into the borrower's personal bank account(s) where they were commingled with other funds. The PLUS funds could be used to pay educational costs from these accounts that did not constitute tuition, fees or institutional charges. At some later time, the same or similar sum that was disbursed to the borrower was paid to the school by the borrower or student with checks from personal accounts, such as credit unions and banks, for the student's tuition, fees or institutional charges.

Attached as *Exhibit 19* are two (2) examples of this situation. In first case, Jaime Flores, the payments to the school were from Western National Bank. In the second case, Jared Baker, one payment was made from Frost National Bank. The fact that these funds match up with the PLUS loan disbursement does not render the funds Title IV revenue. In fact, it is impossible to tell what character the funds are made up of after they have been deposited into personal accounts and commingled with other funds. *Exhibit 8 at 2*. It is also clear, however, that these might be personal funds with the PLUS loan funds having been spent on other legitimate educational expenses. The fact that the same amount disbursed to the parent/borrower is later paid to the school, sometimes months later, does not establish that the funds are Title IV.

Of the \$128,391 paid to the school that was treated as non-Title IV revenue in FY 1997 (that the OIG maintains was misclassified as non-Title IV revenue), all but \$14,902 was correctly classified as non-Title IV revenue.

None of records show, as the Draft Audit states, that the checks were simply endorsed to the school and then misclassified. Rather, the record shows that the school frequently wrote receipts for the sums the OIG is referencing for funds being paid to the school that were being drawn on banking and credit union accounts *Exhibit 19*.

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With respect to the \$21,215 in FY 1997 arising first out of credit balances, the school, again, did not misclassify these funds as non-Title IV revenue. In each of these cases, checks were issued to students because there were credit balances in the student's account. *Exhibit 20*. Under law, the school was required to pay the credit balances to the students. 34 C.F.R. § 668.164(e); *Exhibit 8, Appendix 2*. In all of the cases, the credit balances were also being disbursed because it was the end of the academic year and, again, the school was required by law to disburse those credit balances. *Exhibit 8, Appendix 2, Student Financial Aid Handbook at 3-69*.

The students took the funds and deposited them into personal bank and saving accounts. *Exhibit 21, Declaration of Vanessa Kenon*. The funds were commingled with other funds and lost their character as funds that originated as Title IV funds. Significantly, the only Title IV funds that are counted in the numerator and denominator of the fraction are those used to pay tuition, fees and institutional charges. Credit balances exist after all tuition, fees and institutional charges have been paid. Thus, the funds were not Title IV funds within the meaning of the 85 Percent Rule at that time.

Subsequently, the students paid the school monies in the next academic year in amounts that were the same or similar to the amounts that had been disbursed as credit balances weeks or months earlier. This is, however, irrelevant.

The funds lost any character they might have had as Title IV funds once they were deposited in the student's personal accounts, which were used to pay school and other educational costs. Second, the Department prohibits funds disbursed in one loan period from being used to pay tuition, fees and charges in a subsequent period. Therefore, the funds that the OIG maintains were misclassified, could not have been classified as Title IV funds pursuant to law. Were Hallmark to have done what the OIG says it should do, it would have been in non-compliance with Title IV requirements.

In sum, Hallmark properly treated all the funds at issue as non-Title IV revenue.

IX. HALLMARK AGREES THAT IT ERRONEOUSLY INCLUDED NON-TUITION REVENUE

Hallmark agrees that \$3,027 of non-tuition revenue was erroneously included as non-Title IV revenue in FY 1996.

X.
HALLMARK'S CALCULATIONS SHOULD HAVE INCLUDED
INSTITUTIONAL LOANS

The OIG did not question Hallmark's institutional loan revenue because Hallmark only included as revenue the funds paid by borrowers in the year the payments were made. This is consistent with the position the OIG has taken in other 85/15 cases. Hallmark and its accountants took this approach because it did not believe that it needed any additional revenue to meet the 85 Percent Rule.

A review of Hallmark's institutional loans reveals that about \$353,001 and about \$259,151 were paid out to the students in FY 1996 and FY 1997, respectively. Of these amounts, about \$150,486 was received by the school as payments in FY 1996 and about \$194,689 was received by the school as payment in FY 1997. *Exhibit 5*. The differences of about \$202,515 and about \$64,462 in FY 1996 and FY 1997, respectively, represent the amounts made in those fiscal years that were not counted in the denominator.

Hallmark submits that the amounts that were not treated as revenue should also be counted as non-Title IV revenue in the fiscal years in which the loans were made. As evidenced by the student financial aid packaging and promissory notes signed by students, students entered into valid loans that were enhancements to Hallmark's assets. *Exhibits 24 & 25*. The OIG reaches its conclusion that these amounts should not be counted as revenue because it does not consider the loan when made to be "revenue received" as defined in § 600.5(d)(2)(i). *Id.*

This conclusion is specifically based on a definition of revenue set forth in Financial Accounting Standards Board ("FASB"), Statement of Financial Accounting Concepts No. 6. Exhibit 16. The FASB Concept defines revenue as "inflows or other enhancements of assets" and "actual or expected cash inflows (or the equivalent)". *Id.*

Any analysis of this position must first start with the law. In this regard, a principal source of guidance is the preamble to the final regulations in which the Secretary said that

"an institution is not prohibited from including institutional charges that were paid by institutional scholarships and institutional loans as revenue in the denominator of the fraction...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." 59 *Fed. Reg.* 22324 (April 29, 1994), *Exhibit 7*.

Institutions and accountants reviewing this language have frequently concluded, without qualification, that the above quoted statement clearly meant

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what it says, that is, that institutional loans could be treated as revenue in the denominator of the fraction. See *Exhibits 10-12 & 22*. The OIG focuses on the word "paid" in the above quoted statement to argue that the Secretary only meant to treat as revenue those payments made on the loan as an inflow of revenue or cash from a source external to the institution.

This argument is misplaced. Among other things, SFAC 6 is not intended to define the timing of recognition of revenue. *Exhibit 8, Appendix 1*. Cash basis is not a GAAP concept, as such, the source of authority to interpret the Secretary's regulation and comments is not SFAC 6 but rather the Secretary's own guidance, as limited as that may be. *Id.* Simply put, the Secretary's straight forward language means that if the loans are valid and not part of a scheme to artificially inflate tuition and fees, then they may be counted as revenue in the denominator of the fraction at the time that the loan is credited or posted to the student's account. Further, these loans represent "other enhancements of assets" as defined by SFAC 6. *Exhibit 8, Appendix 1*.

Institutions and their accountants have also recognized, however, that the regulation and preamble were not a model of clarity. See e.g. *Exhibits 10-12* including one CPAs call to Ms. Leibovitz, the person designated by the Department in the final regulation as the point of contact for any questions involving the 85 Percent Rule. *Exhibit 12 at 1* and *Exhibit 7 at 22324*. Others such as Dr. Sharon Bob, a financial aid consultant, and the accounting firm of Ehrhardt Keefe Steiner & Hottman, PC, of Denver, Colorado, sought guidance and confirmation in writing. *Exhibits 10 & 11*.

On May 13, 1994, within two weeks after the final regulation was published, Dr. Sharon Bob, a well known financial aid consultant, wrote Ms. Leibovitz asking for confirmation that institutional loans could be treated as revenue in the denominator of the fraction in the year in which the loans were made. *Exhibit 10*. On August 24, 1994, about three months later, Ms. Leibovitz responded with countersignature evidencing her agreement with Dr. Bob's interpretation of the regulation on this point. The fact that it took Ms. Leibovitz three months to respond indicates that the affirmation was provided only after a deliberative and well reasoned consideration of the question.

At about the same time that Ms. Leibovitz was considering her response and without either party knowing about the other, Ms. Tostenrud called Ms. Leibovitz in early August to ask a series of questions about the Rule. *Exhibit 12*. All of Ms. Tostenrud's questions are attached to her letter. *Exhibit 12*. The second question on her list is whether the note receivable can be treated as a payment on the account in the year in which the institutional loan was made. Ms. Leibovitz directed Ms. Tostenrud to call Mr. Pat Howard of the OIG to obtain answers to her questions.

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On August 16, 1994, she spoke with Mr. Howard. *Id.* Mr. Howard's answer was "yes"; the amount of the loan could be treated as a payment on the account so long as the loan was a valid or real loan, exactly as Hallmark did. *Id.* Coincidentally or not, Ms. Leibovitz responded to Dr. Bob's letter within days after Ms. Tostenrud's conversation.

The letter countersigned by Ms. Leibovitz, Mr. Howard's response to Ms. Tostenrud and Hallmark's treatment of institutional loans are all fully consistent. About two years later, in 1996, another accounting firm wrote Ms. Leibovitz and asked the same question. *Exhibit 11.* On the Department's behalf, Ms. McCullough of the Policy Division also answered in the affirmative.

This information and, in particular, Dr. Bob's letter, were widely disseminated around the country and among proprietary institutions. See e.g. *Exhibit 22 at ¶ 12 (Declaration by Nancy Broff, General Counsel, Career College Association indicating that Leibovitz was appropriate person to respond to this issue and that CCA widely disseminated the letter).* Others such as Dr. Bob herself and this Firm widely disseminated it as well.

As noted in Dr. Bob's countersigned letter, the question was of profound importance to the proprietary sector, which was why she specifically wanted a countersignature. The letter could not answer the question any more clearly.

Hallmark's interpretation of the law is fully consistent with the regulation, the preamble to the regulation and the "supplementary" guidance issued by the Department and the OIG. Their interpretation and application of this interpretation of the 85 Percent Rule was made in good faith reliance on all available evidence and instruction. *Exhibit 5.*

XI. **THE DEPARTMENT IS OBLIGATED TO APPLY ITS REGULATIONS** **UNIFORMLY**

The Higher Education Act requires the Secretary to uniformly apply and enforce his regulations throughout the country. 20 U.S.C. § 1232 (c). See *Chula Vista City School Dist. V. Bennett*, 824 F.2d 1573, 1583 (Fed. Cir. 1987), *cert. den.*, 484 U.S. 1042 (1988); *In the Matter of Blair Junior College*, Dkt. No. 93-23-SP (June 1, 1994)(Dec. of ALJ Cross) at 26 (Exhibit 14); *In the Matter of Nettleton Junior College*, Dkt. No. 93-29-SP (June 8, 1994)(Dec. of ALJ Cross)(Exhibit 14). This principle is embodied in the concept of equal protection of the law. Equal protection "is essentially a direction that all persons similarly situated should be treated alike." *City of Cleburne, Texas v. Cleburne Living Center*, 473 U.S. 432, 439 (1985).

Were the Department to accept the interpretation of the 85 Percent Rule and institutional charge definition now being advanced by the OIG for 85/15

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analysis to past years, this fundamental principle would be violated since other similarly situated Colleges are not being treated alike.

XII. HALLMARK IS ENTITLED TO RELY ON ITS CALCULATION WHICH WAS RENDERED IN GOOD FAITH AND WITH NO GUIDANCE WITHOUT PENALTY OR THE THREAT OF PENALTY

Hallmark and its accountant calculated the 85/15 percentage in good faith and without adequate guidance from the Department or the OIG. The OIG does not question Hallmark's good faith. Good faith and reasonable interpretations of the law should be entitled to be made without threat of penalty, whether in terms of liabilities or eligibility.

Hallmark's good faith actions are clearly shown by the way in which it handled the possibility of retraining employees from Kelly Air Force Base which is being phased out. After applying to handle this work and being selected, Hallmark turned down the multi-million dollar training project which it estimates would have generated at least \$200,000 in non-Title IV revenue in FY 1996 and at least \$1.5 million in FY 1997 for students enrolled in eligible programs. *Exhibit 5.*

This contract alone would have solved Hallmark's 85 Percent Rule requirements. However, since Hallmark believed it was already in compliance with the 85 Percent Rule and because the school felt there were some negatives attached to participating in the Alamo program, Hallmark opted not to participate. *Exhibit 23.* Hallmark was not interested in jeopardizing its 30-year reputation and track record just for the money.

XIII. CONCLUSION

Hallmark's 85/15 calculations for FY 1996 and FY 1997, based on the arguments and adjustments discussed above, reveal that Title IV revenue was 79% and 82.3% for the two years, respectively. Were Hallmark's original calculations retained except to reduce the non-Title IV revenue by \$3,027 in FY 1996 and \$14,902 in FY 1997, the resulting calculations would be 84.4% in FY 1996 and 83.5% in FY 1997. Were the OIG calculations altered to only add the amount of the institutional loans made to students that were not previously counted in the denominator, Hallmark's Title IV revenue would be 81% in FY 1996 and 86.2% in FY 1997.

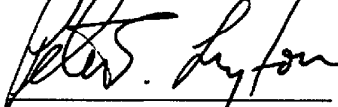
The evidence demonstrates that Hallmark's calculations were made in good faith, that the Institution is unquestionably in compliance with the 90 Percent Rule for fiscal years 1996, 1997 and 1998, that it acted in reliance on the Department's limited guidance and, perhaps, misstatements, that it acted in

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reasonable reliance on its accountants, that it has a good Title IV compliance history and that its calculations are accurate and, especially under the circumstances, reasonable.

For all of these reasons, Hallmark respectfully submits that the OIG should withdraw its conclusions and recommendations.

Respectfully submitted,



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Dated: July 30, 1999

**HALLMARK INSTITUTE OF AERONAUTICS'S
RESPONSE TO THE OFFICE OF INSPECTOR
GENERAL'S DRAFT AUDIT REPORT**

ACN 06-80013

BOOK 1 OF 5

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