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OFFICE OF INSPECTOR GENERAL**

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November 22, 2005

Control Number ED-OIG/A07F0012

John M. Larson
Chairman of the Board, President, and
Chief Executive Officer
Career Education Corporation
2895 Greenspoint Parkway, Suite 600
Hoffman Estates, IL 60195

Dear Mr. Larson:

This Final Audit Report, titled *Sanford-Brown College's (SBC) Compliance with the 90-10 Rule for the 2003 Fiscal Year*, presents the results of our audit. The objective of our audit was to determine whether SBC complied with the 90-10 Rule, Section 102(b)(1)(F) of the Higher Education Act of 1965, as amended (HEA), and had sufficient, reliable accounting records to support the calculation for the 2003 fiscal year (January 1 through December 31, 2003). The 90-10 Rule states that, to be eligible for Title IV, HEA program participation, a proprietary institution may derive no more than 90 percent of its revenue from the Title IV, HEA programs.

For the 2003 fiscal year, SBC did not derive more than 90 percent of its revenue from the Title IV, HEA programs. However, SBC did not have sufficient, reliable accounting records to support a precise 90-10 Rule calculation in accordance with the regulations. As a result, Career Education Corporation (CEC), the parent company of SBC, reported inaccurate 90-10 Rule information in its 2003 financial statements. CEC reported SBC derived 80 percent of its revenue from Title IV, HEA program sources. However, we determined SBC derived more than 80 percent of its revenue from Title IV, HEA program sources. We estimate that the actual percentage was about 82 percent.

In response to the draft of this report, CEC concurred with our finding and recommendations with the exception of item 3. CEC also concurred that revenue/refund transactions involving Title IV, HEA program funds were misclassified. CEC disagreed with item 3 in the finding, citing a 1999 ED Policy Interpretation and Guidance Publication as its primary support for its position regarding classification of institutional charges. CEC's response also outlined planned corrective actions, which included training and strengthening of procedures for preparing the 90-10 Rule calculation. In response to recommendation 1.1, CEC outlined revised procedures for calculating the 90-10 Rule percentage. In response to recommendation 1.2, CEC stated it is

willing to re-calculate the 90-10 Rule percentage for SBC's 2004 fiscal year and report the percentage to Federal Student Aid.

We summarized CEC's comments after the recommendations and included CEC's comments on the draft report in their entirety as an Attachment. CEC's comments did not result in a change to our recommendations. However, after reviewing additional information provided by CEC in response to the draft report, we reduced the amount of non-institutional revenue that should have been excluded from the denominator of the calculation (item 3) in the finding from \$289,632 to \$128,705.

BACKGROUND

SBC is a proprietary institution with a main campus in Fenton, Missouri, and additional locations in the St. Louis, Missouri, metropolitan area. During the audit period, SBC participated in the Federal Pell, Federal Supplemental Educational Opportunity Grant (FSEOG), Federal Family Education Loan, and Federal Work Study programs. SBC is accredited by the Accrediting Council for Independent Colleges and Schools.

CEC purchased SBC in July 2003. CEC is located in Hoffman Estates, Illinois, and is a publicly traded company that owns and operates campuses that provide private, for-profit, postsecondary education. As of December 31, 2003, CEC owned and operated 78 campuses that provide private, for-profit, postsecondary education in the United States, Canada, the United Kingdom, France, and the United Arab Emirates. According to CEC's financial statements, SBC derived 80 percent (\$24,414,580) of its total revenues (\$30,636,031) from Title IV, HEA program sources for its fiscal year ending December 31, 2003.

AUDIT RESULTS

Finding SBC's 90-10 Rule Calculation Was Not Prepared in Accordance with Federal Regulations

CEC did not calculate the percentage of revenue SBC derived from the Title IV, HEA programs for the 2003 fiscal year in accordance with the federal regulations. In calculating SBC's percentage, CEC:

1. Included non-cash revenue in the denominator of the calculation;
2. Included its FSEOG matching contribution as revenue in the denominator of the calculation;

3. Included revenue from all charges, including non-institutional charges, in the calculation;
4. Did not apply Title IV, HEA program funds before applying non-Title IV, HEA program revenue to tuition and fees (Title IV, HEA program funds were paid to students as a return of credit balances and non-Title IV, HEA program funds covered tuition and fees); and
5. Misclassified Title IV, HEA program revenue/refund transactions as non-Title IV, HEA program revenue and non-Title IV, HEA program revenue transactions as Title IV, HEA program revenue.

Section 102(b)(1)(F) of the HEA provides that a proprietary institution must have “at least 10 percent of the school’s revenues from sources that are not derived from funds provided under title IV, as determined in accordance with regulations prescribed by the Secretary.” Pursuant to 34 C.F.R. § 600.5(a)(8),¹ to be eligible to participate in the Title IV, HEA programs, a proprietary institution must have “no more than 90 percent of its revenue derived from title IV, HEA program funds.”

The following formula for calculating the percentage for an institution’s latest complete fiscal year is found at 34 C.F.R. § 600.5(d)(1):

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

The sum of revenues including title IV, HEA program funds 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.

Pursuant to 34 C.F.R. § 600.5(e)(1)(iii) and (v), “[t]he institution may not include as title IV, HEA program funds in the numerator nor as revenue generated by the institution in the denominator . . . (iii) The amount of institutional funds it used to match title IV, HEA program funds, . . . or (v) The amount charged for books, supplies, and equipment unless the institution includes that amount as tuition, fees, or other institutional charges.”

The regulations at 34 C.F.R. § 600.5(d)(2) provide that “[a]n institution must use the cash basis of accounting when calculating the amount of title IV, HEA program funds in the numerator and the total amount of revenue generated by the institution in the denominator of the fraction . . .” According to 34 § C.F.R. 600.5(e)(2), “[i]n determining the amount of title IV, HEA program funds received by the institution under the cash basis of accounting . . . the institution must presume that any title IV, HEA program funds disbursed or delivered to or on behalf of a student will be used to pay the student’s tuition, fees, or other institutional charges, regardless of whether

¹ Unless otherwise specified, all regulatory citations are to the July 1, 2002, volume.

the institution credits those funds to the student's account or pays those funds directly to the student, and therefore must include those funds in the numerator and denominator.”

CEC did not properly calculate the 90-10 Rule percentage for SBC because it did not have sufficient, reliable accounting records to support a precise 90-10 Rule calculation. Specifically, CEC's process for preparing the 90-10 Rule calculation does not include procedures to ensure Title IV, HEA program funds are applied before applying non-Title IV, HEA program revenue to tuition and fees. When we brought the errors to CEC's attention, CEC's Vice President of Government Relations informed us that CEC included the non-cash revenue items and FSEOG matching contribution in the calculation because a new person was assigned the responsibility for reviewing the calculation and did not fully understand the calculation methodology. In addition, CEC management chose to classify all charges posted to the students' accounts as institutional charges in accordance with a January 7, 1999, U.S. Department of Education policy bulletin. CEC's Vice President of Government Relations also stated that CEC's conversion to a new computer system and manual coding errors resulted in (1) Title IV, HEA program funds not being applied to tuition and fees first and (2) the misclassification of the revenue/refund transactions as non-Title IV, HEA program revenue and non-Title IV, HEA program revenue transactions as Title IV, HEA program revenue.

As a result of improperly calculating the percentage of revenue SBC derived from Title IV, HEA program sources, CEC reported inaccurate 90-10 Rule information for SBC in its 2003 financial statements. CEC reported that SBC derived 80 percent of its revenue from Title IV, HEA program sources for the 2003 fiscal year. However, we estimate that the revenue SBC derived from Title IV, HEA program sources was about 82 percent for the 2003 fiscal year. The following four items increased the percentage of revenue SBC derived from Title IV, HEA program sources.

1. CEC included \$555,755 of non-cash revenue in the denominator of the calculation.
2. CEC included \$65,413 of FSEOG matching funds in the denominator of the calculation.
3. CEC included revenue from all charges in the 90-10 Rule calculation, failing to exclude \$128,705 in non-institutional revenue from the denominator of the calculation.
4. CEC did not apply an estimated \$94,015 in Title IV, HEA program funds before applying non-Title IV, HEA program revenue to tuition and fees (Title IV, HEA program funds were paid to students as credit balances, and non-Title IV, HEA program funds were applied to tuition and fees).²

² Using information obtained from Campus 2000, we analyzed data for all students receiving Subsidized Stafford loan funds, a stipend payment coded as Subsidized Stafford loan funds, and non-Title IV loan funds. We identified 94 students who received a total of \$94,015 in stipends coded as Subsidized Stafford loan funds. We reviewed the electronic student ledger cards for 2 of the 94 students to determine if Title IV, HEA program funds were applied before non-Title IV, HEA program funds to pay for tuition and fees. We identified \$1.45 million in cash disbursements to students. We only evaluated the appropriateness of claiming the disbursements as Title IV cash disbursements to students who received non-Title IV loans in addition to Title IV loans. The \$94,015 is the total amount of cash disbursed to students for this group. If the entire \$1.45 million were improperly classified as Title IV cash disbursements to students, the percentage of revenue SBC derived from Title IV, HEA program sources would increase to 87 percent.

In addition, CEC misclassified 13 revenue/refund transactions involving Title IV, HEA program revenue categories. If these 13 transactions had been properly classified, the numerator of the calculation would have decreased by \$2,915.³

Recommendations

We recommend that the Chief Operating Officer for Federal Student Aid require CEC to:

- 1.1 Establish policies and procedures that ensure it will calculate the percentage of revenue derived from the Title IV, HEA programs in compliance with the requirements set forth in 34 C.F.R. § 600.5.
- 1.2 Recalculate the 90-10 Rule percentage for SBC's 2004 fiscal year and report the percentage to Federal Student Aid.

CEC's Comments

CEC concurred that it did not calculate SBC's 90/10 Rule percentage in strict compliance with the regulations. CEC agreed that it

- (1) improperly included non-cash revenue in the denominator of the calculation, stating that the inclusion of non-cash revenue was primarily a training issue and not consistent with the attached procedures [Item 1 in the finding];
- (2) improperly included FSEOG matching contributions in denominator of calculation, stating inclusion of non-cash revenue was primarily a training issue and not consistent with the attached procedures [Item 2 in the finding];
- (3) erroneously, classified as resulting from Title IV funds, certain stipend payments made to students primarily due to a systems conversion issue that has been addressed [item 4 in the finding]. CEC included revised procedures for preparing the 90-10 Rule calculation.

However, CEC generally disagreed that it included revenue from non-institutional charges in SBC's 90/10 Rule calculation [item 3 in the finding]. CEC agreed that application fees for students who did not start school (\$25,548) should be excluded from the denominator of the calculation but disagreed that revenue from application fees for students that did start school (\$44,873) should be excluded. CEC stated that, for students who started school, the fee is a required fee that is charged to students for processing their application and is an institutional charge. CEC also disagreed that revenue from credit-by-experience exam fees, miscellaneous charges, sales tax, and testing fees should be excluded from the calculation. CEC cited 1999 ED Policy Interpretation guidance regarding calculating institutional refunds as its primary support for its position that an institution is never compelled by federal law and regulations to classify a charge as non-institutional if it wishes to classify the charge as institutional.

³ CEC misclassified three non-Title IV revenue transactions totaling \$5,109 as Title IV transactions and 10 Title IV revenue transactions totaling \$2,194 as non-Title IV revenue transactions.

Corrective Action

As part of its response to the draft report, CEC acknowledged that further training is necessary, and it will strengthen its policies and procedures to ensure it calculates the percentage of revenue derived from Title IV, HEA programs in compliance with the requirements in 34 C.F.R. § 600.5. CEC included revised procedures for calculating the percentage with its response. CEC provided a revised 90/10 reporting procedure that includes a step to review the “Null” revenue account for transactions that were not properly categorized and a step to make appropriate adjustments to the numerator and/or denominator of the calculation.

OIG Response

We agree with CEC that revenue from the testing fees and miscellaneous charges discussed in its response may be included as revenue in the denominator of the 90-10 Rule calculation. Accordingly, we dropped the two categories from item 3 of the finding. We also revised the dollar amounts included in the finding to reflect actual revenue received instead of the estimated amounts we included in the draft of this report.

However, we disagree with CEC that revenue from application fees for students who started school may be classified as institutional revenue. We also disagree with CEC that revenue from sales tax and credit by experience exam fees may be included as revenue in the calculation.

Application Fees

CEC’s assertion that the application fees for students who started school may be included as revenue in the calculation is contrary to the 90/10 Rule regulation. The regulation is clear that the institution may only include in the denominator of the calculation revenue generated for students enrolled in an eligible program as defined in 34 C.F.R. § 668.8. At the time the students paid the application fees, the students were not enrolled at SBC [34 C.F.R. § 600.5(d)(1)].

Sales Tax

We do not agree with CEC’s assertion that sales tax is a required expense associated with the purchase of books and supplies and therefore can be included as revenue in the denominator of the calculation. By definition, sales tax cannot be a source of revenue and should be excluded from the calculation. According to Kieso & Weygandt, Eighth edition, *Intermediate Accounting*, “revenues are inflows or other enhancements of assets of an entity or settlement of its liabilities (or a combination of both) during a period from delivering or producing goods, rendering services, or other activities that constitute the entity’s ongoing major or central operations.” Kieso & Weygandt also discuss Sales Taxes Payable as “a liability to provide for taxes collected from customers but not yet remitted to the tax authority” and include an example of the required entry. The appropriate accounting entry is to reduce the amount of sales by the amount of the applicable sales tax when sales and sales tax are not segregated at the time of the sale. The amount of sales tax is debited to Sales and credited to Sales Taxes Payable. Therefore, Sales Taxes are not treated as revenue.

Credit-by-Experience Exam Fees

We disagree that there is no basis for the institution to demonstrate that the charge is non-institutional simply because CEC has not chosen to designate the charge as non-institutional. The fees were paid so SBC would evaluate activities that occurred prior to the student's enrollment at SBC. The fees were not revenue generated by SBC for students while they were attending SBC for educationally related activities conducted by the institution [34 C.F.R. § 600.5(d)(1)].

Corrective Action

CEC stated that it has revised its procedures to ensure that it calculates the 90/10 Rule percentage in compliance with the regulations. We analyzed CEC's revised procedures and do not believe the procedures will ensure that CEC calculates a precise 90-10 Rule percentage. The revised procedures still do not provide reasonable assurance that Title IV, HEA program funds are applied to tuition and fees before non-Title IV, HEA program funds (Item 4 of the finding). During 2003, SBC misclassified non-Title IV stipends paid to students as Title IV stipends. Per the 90/10 regulation, stipends are to be deducted from revenue for purposes of the calculation. Under CEC's revised procedures, Title IV stipends are added back to total revenue (denominator) and also included in the numerator. CEC needs a process for determining the precise amount of Title IV and non-Title IV funds that are used for tuition, fees, and other institutional charges. CEC's proposed corrective action will not satisfy this requirement.

To illustrate why the revised procedures will not provide reasonable assurance that CEC calculates and reports a precise 90-10 Rule percentage, we present the following example:

A student receives \$5,600 in financial aid, consisting of a \$1,100 Federal Pell Grant, a \$2,000 Federal Subsidized Stafford Loan, a \$2,000 Federal Unsubsidized Stafford Loan, and a \$500 alternative loan (non-Title IV). CEC applies \$5,000 to tuition and fees and pays the student \$600 as a stipend (\$500 from the alternative loan and \$100 from the Pell Grant). The student then purchases \$100 in books at the school's book store. The amount that should be included in the denominator of the calculation is \$5,000 for tuition and \$100 for books, and the correct 90-10 Rule percentage should be 100 percent ($\frac{\$5,100 \text{ in Title IV funds}}{\$5,100 \text{ in total revenue}}$). The \$500 in alternative loan funds should not be included as revenue in the denominator because the alternative loan funds were paid to the student as a stipend. Absent a policy for ensuring that Title IV funds are used first to pay tuition and fees, and due to the systemic problem with misclassifications, the \$500 alternative loan revenue could be picked up in CEC's Campus 2000 revenue report used to prepare the 90-10 Rule calculation as coming from Title IV sources when it should have been coded as financed by the alternative loan funds (non-Title IV). Using CEC's revised procedures for calculating the 90-10 Rule percentage, the numerator would include the \$5,100 in Title IV funds. The denominator would include the \$5,000 in Title IV revenue ($\$5,100 \text{ total Title IV funds less } \$100 \text{ paid to the student as a stipend}$), the \$500 in alternative loan revenue, the \$100 in Pell Grant funds paid as a stipend, and the \$100 that the student paid for books (total of \$5,700). Under its revised procedures, CEC would report the percentage of revenue derived from Title IV sources as 89.5

percent ($\$5,100/\$5,700$) instead of the correct percentage of 100. Even if CEC's system did not identify the \$500 paid as a stipend from alternative loan funds as a Title IV stipend, CEC's calculation would still be incorrect. The process would result in tuition of \$5,000, books of \$100, and a Title IV stipend of \$100 to be included in the denominator, resulting in a reported percentage of 98.1 percent ($\$5,100/\$5,200$), not the correct percentage of 100.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of the audit was to determine whether SBC complied with the 90-10 Rule, Section 102(b)(1)(F) of the HEA, and had sufficient, reliable accounting records to support the calculation. Our audit covered SBC's 2003 fiscal year (January 1 through December 31, 2003).

To achieve our objective, we:

- Obtained background information on CEC and SBC, including Title IV, HEA program funding data and prior audit reports;
- Reviewed the Independent Public Accountant's audit documentation regarding certification of CEC's management's assertion on compliance with the 90-10 Rule;
- Obtained an understanding of CEC's policies and procedures for preparing SBC's 90-10 Rule calculation for the 2003 fiscal year;
- Obtained SBC's 90-10 Rule calculation and supporting detail;
- Analyzed and derived the composition of the numerator and denominator for the 90-10 Rule calculation for SBC;
- Compared the 90-10 Rule supporting detail to CEC's and SBC's accounting records; and
- Obtained an understanding of SBC's policies and procedures for entering revenue data into the Campus 2000 system.

In addition, we relied, in part, on CEC's revenue data. CEC uses computer software called Campus 2000. To calculate the 90-10 Rule percentage, CEC used a Campus 2000-generated report titled *Cash Receipts Summary by Fund Source* (CRSFS). The report lists cash receipts by fund source and shows the 90-10 Rule percentage. We obtained the data for the CRSFS report. The data included detailed revenue transactions for 23 fund source categories. To assess the reliability of the data, we performed logic tests and compared CEC's data to the U.S. Department of Education's data. Based on our tests, we concluded that the data CEC provided was sufficiently reliable for the purpose of our audit.

To select samples of revenue transactions for review of supporting documentation, we stratified SBC's 23 fund sources into 3 groups (large, medium, and small) based on total dollar value and number of transactions within the group. For the large group, we randomly selected 399 revenue transactions (from a total of 43,384 transactions) and judgmentally selected another 40 to ensure coverage of negative transactions within each fund source. For the medium and small groups, we judgmentally selected 206 revenue transactions (from a total of 2,967) to ensure coverage of

all campuses, coverage of large revenue amounts per student, and large refund and stipend amounts.

Finally, we gained an understanding of CEC's system of internal control over determining the amount of revenue SBC derived from the Title IV, HEA programs. We did not assess the adequacy of CEC's system of internal control. However, our review of revenue data and accounting records disclosed instances of non-compliance with federal regulations that led us to believe weaknesses existed in CEC's system of internal control over preparation of the 90-10 Rule calculation. These weaknesses and their effect are discussed in the AUDIT RESULTS section of this report.

We conducted our audit work at CEC Headquarters in Hoffman Estates, Illinois; SBC's main campus in Fenton, Missouri; and SBC's additional locations in St. Charles and Hazelwood, Missouri, and Collinsville, Illinois. We discussed the results of our audit with CEC officials on May 4, 2005.

We conducted the audit in accordance with generally accepted government auditing standards appropriate to the scope of the audit described above.

ADMINISTRATIVE MATTERS

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

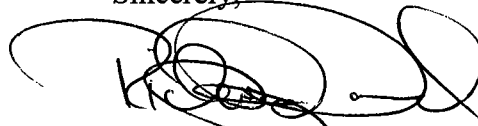
This report incorporates the comments you provided in response to the draft report. If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Education Department official, who will consider them before taking final Departmental action on this audit:

Theresa S. Shaw, Chief Operating Officer
Office of Federal Student Aid
U.S. Department of Education
Union Center Plaza, Room 112G1
830 First Street, N.E.
Washington, D.C. 20202

It is the policy of the U.S. Department of Education to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within 30 days would be appreciated.

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

Sincerely,

A handwritten signature in black ink, appearing to read "Richard J. Dowd", with a large, stylized flourish extending to the left.

Richard J. Dowd
Regional Inspector General for Audit

Attachment



August 25, 2005

Richard J. Dowd
Regional Inspector General for Audit
U.S. Department of Education
Office of Inspector General
111 N. Canal Street, Suite 940
Chicago, IL 60606-7297

Control Number ED-OIG/A07-F0012

Dear Mr. Dowd:

In response to the Draft Report, titled Sanford-Brown College's (SBC) Compliance with the 90-10 Rule for the 2003 Fiscal Year, Career Education Corporation concurs that certain non-cash revenue (including FSEOG matching funds) was erroneously included in the calculation for the 2003 fiscal year (items 1 and 2). Further, Career Education Corporation concurs that certain stipend payments made to students were erroneously classified as resulting from Title IV funds (item 4). The inclusion of non-cash revenue was primarily a training issue and not consistent with the attached procedures. The misclassification of stipends was primarily a systems conversion issue that has been addressed.

Although Career Education generally concurs with the finding, Career Education Corporation does not agree that the amount cited in the finding (item 3) as the amount that should have been excluded as non-institutional revenue (\$289,632) is accurate. The January 1, 1999 Policy Interpretation and Guidance under the "Subject: Calculating Institutional Refunds: What Are Institutional Charges?" issued by Policy Development Division of Federal Student Aid states "an institution is never compelled by federal law and regulations to classify a charge as non-institutional if it wishes to classify the charge as institutional. However, if an institution wishes to exclude specific charges or costs from a refund calculation, it must demonstrate the charges are either non-institutional or are designated as excludable costs under the regulations." The institution can find no material in either the Code of Federal Regulations (CFR) 34 or Dear Colleague letters that state the revenue cited on page 7, item 3, of the Draft Report must be excluded. While the amount that the Draft Report indicates should be excluded as non-institutional revenue may appear insignificant, the institution believes the charges were appropriately included in the denominator. As some items listed may be considered "pass-through" charges, it should also be noted that a "pass-through" charge does not necessarily mean it is a non-institutional charge. For example, student group health insurance is an institutional charge unless "the insurance is required for all students and the coverage

remains in effect for the entire period for which the student was charged, despite the student's withdrawal." Thus, the mere fact it is a "pass-through" charge does not automatically exclude it as an institutional charge.

In addition to disagreeing that the charges cited represent non-institutional revenue that must be excluded from the calculation, it is further noted that the amounts cited represent net invoiced amounts rather than cash transactions. Reports indicating the cash receipts related to these charges are attached.

Specifically,

- Credit-by-experience exam fees (\$600 in the Draft Report) were fees for an exam the student takes to demonstrate mastery of coursework for which the student receives course credit, if supported by passing the exam. There is no basis for the institution to demonstrate the charge is non-institutional.
- Miscellaneous charges (\$55 in the Draft Report) represented bank fees for not sufficient funds (NSF) on checks written by students to the school and represent a charge incurred by the student to the school.
- The sales tax (\$78,758.29 in the Draft Report) was the sales tax on books and supplies purchased by the student. The sales tax is a required expense associated with the purchase of the books and supplies. While Sanford-Brown College separated the sales tax from the books and supplies charges on the student account ledger, the sales tax was a part of the books and supplies purchase. The institution has no basis to demonstrate the charge is non-institutional.
- Testing fees (\$113,986 in the Draft Report) were primarily fees for special courses that prepare students in certain academic programs (e.g., nursing, radiography, and respiratory therapy) to take their board exams. In addition, there were fees for required physical examinations taken at Sanford-Brown College-Collinsville for students in the medical office administration program. Finally, fees at several campuses were related to IT certification exams for students in networking programs. These fees are related to preparing students to take board exams so they may enter the profession for which they were trained, the cost of certification exams so students are better credentialed to enter the job market in the profession for which they were trained, or for physical examinations (which no longer are classified as testing fees) required in certain academic programs. There is no basis to demonstrate these charges are non-institutional.
- Admissions fees (\$96,232.30 in the Draft Report) included both students who started schools and those who did not start schools. For students who started school, admissions fee is a required fee which is charged to students for processing their application. It is acknowledged that only such fees for students who actually started schools should be included as students enrolled in an eligible program. Therefore, \$28,031.89 should be excluded from the denominator as that is the difference between cash receipts for admissions fees for all potential

students and that received for students who started classes. However, the fees for students who started school are institutional charges.

Beyond the adjustment for admissions fees for students who did not start school, as noted above, the cash receipts represented by payment of the charges cited as amounts that should be excluded from revenue represent appropriate revenue for the 90/10 calculation and item 3 should be removed from the Draft Report.

Career Education Corporation does agree that certain student stipend payments were inaccurately associated with Title IV, HEA program funds. This was primarily due to a systems conversion issue and has been addressed.

Career Education Corporation acknowledges that further training is necessary based on the findings and has proceeded to strengthen the procedures as noted in the recommendation to "establish policies and procedures to ensure that it will calculate the percentage of revenue derived from the Title IV, HEA programs in compliance with the requirements set forth in 34 C.F.R. 600.5." Attached are revised procedures relative to the calculation of 90-10.

While Career Education is willing "re-calculate the 90-10 Rule percentage for SBC's 2004 fiscal year and report the percentage to Federal Student Aid," we shall await a response from the U.S. Department of Education regarding submission of the re-calculated percentage if it does not reach the 90% threshold.

Please contact me if you have questions or require additional information.

Sincerely,



John M. Larson
Chairman of the Board, President, and Chief Executive Officer

Enclosures

90/10 Reporting

To be eligible for participation in the federal student aid programs, a proprietary institution may derive no more than 90% of its revenue from Title IV funds. A school must determine its revenue percentages using the following formula for its latest complete fiscal year:

Title IV Funds (excluding LEAP and FWS) used for tuition, fees, and other institutional charges to students

The sum of revenues generated by the school from tuition, fees, and other institutional charges for students enrolled in eligible training programs plus school activities necessary for the education or training of students enrolled in those eligible programs

A proprietary institution must use the cash basis of accounting in determining whether it satisfies the 90/10 Rule. Under the cash basis of accounting, revenue is recognized when received. In order for an institution to recognize revenue under the cash basis of accounting, that revenue must represent cash received from a source outside the institution.

Title IV Funds (Numerator)

For purposes of determining the 90/10 calculation, the following funds are considered Title IV: Federal Pell Grants, Federal SEOG (federal share only), Federal Stafford Loans (Subsidized and Unsubsidized), Federal Perkins Loans, and Federal PLUS Loans.

The totals do not include refunds paid to or on behalf of students who have withdrawn, dropped out, been expelled, or otherwise failed to complete the period of enrollment. However, in figuring what Title IV funds were used to pay tuition, fees, and other institutional charges, an institution must assume that any Title IV funds disbursed or delivered to, or on behalf of, a student were used for such costs, regardless of whether the institution credits those funds to the student's account or pays them directly to the student, unless those costs were otherwise paid by grant funds provided by nonfederal public agencies, grant funds provided by independent private sources, funds from qualified government agency job training contracts, or funds received from a prepaid state tuition plan. Therefore, stipends to students are appropriate only to the extent such stipends were for Title IV funds that exceeded tuition, fees, and other institutional charges (less grant funds provided by nonfederal public agencies, grant funds provided by independent private sources, funds from qualified government agency job training contracts, or funds received from a prepaid state tuition plan) for the fiscal year.

Revenues (Denominator)

In addition to tuition, fees, and other institutional charges (e.g., books and supplies) (Note: the tuition, fees, and other institutional charges totals do not include refunds paid to or on behalf of students who have withdrawn, dropped out, been expelled, or otherwise failed to complete the period of enrollment.), an institution may only include revenue generate by the institution from activities it conducts that are necessary for it education or training These activities must be conducted on campus or at a facility under the control

of the institution; performed under the supervision of a member of the institution's faculty; and required to be performed by all students in a specific educational program at the institution. Examples of such activities would be restaurant revenue at schools with culinary programs, if the preceding conditions are met or message therapy clinic revenue at schools with message therapy programs, if the preceding conditions are met.

Institutional grants in the form of tuition waivers do not count as revenue because no new revenue is generated. Therefore, such fund sources as institutional grants, institutional scholarships, or staff grants (or employee grants) are excluded from revenues. One exception is donations from a related party to create restricted accounts for institutional scholarships, but only the amount earned on the restricted account and used for scholarships would count as revenue in the denominator.

Loans made by a private lender that are in any manner guaranteed by the institution are known as recourse loans. The proceeds from recourse loans may be included in the denominator of an institution's 90/10 calculation for the fiscal year in which the revenues were received, provided that the institution's reported revenues are also reduced by the amount of recourse loan payments made during that year. Therefore, total revenues from Recourse Loans and ELF Loans must be reduced by the amount of recourse loan payments made by the institution (or CEC) during the fiscal year for those loans.

Process for determining 90/10 calculation

The CampusVue Cash Receipts Summary by Fund Source report is used to calculate the 90/10 percentage for each OPE ID within the CEC system. The OPE ID often includes the main campus and affiliated additional locations. The transaction dates selected in the report match the fiscal year (e.g., 1/1/04 through 12/31/04 for the 2004 fiscal year). School statuses selected in the report include only statuses for students who attended the school (e.g., original enrollments would not be included as they did not attend classes at the school). Fund sources selected in the report should exclude non-cash fund sources as described above.

Once the report is run, the numerator should be the Title IV Grand Totals using the Net received column (i.e., before Stipends). The denominator should be the Grand Total using the Net Received less Stipends column plus the Total Stipends for the Title IV funds (since the Title IV Stipends were not excluded from the numerator, they must be added back into the denominator). Also, if a school includes both the federal share and the institutional match in the SEOG fund, it must reduce both the numerator and denominator by 25% of the Net Received (e.g., if \$12,000 of SEOG includes a federal share of \$9,000 and an institutional match of \$3,000, only \$9,000 is included in the numerator and denominator). Finally, recourse loans in the denominator are to be reduced by the amount of recourse loan payments made during the fiscal year by the school or CEC on behalf of the school.

Once the appropriate adjustments have been made to the Cash Receipts by Fund Source report, the Student Fund Source (i.e., Null account) should be reviewed to determine

those transactions that are not properly categorized and make appropriate adjustments to the numerator and/or denominator (maintaining the documentation to support the adjustments). Also, the other revenue (e.g., restaurant revenue or massage therapy clinic revenue as described above) may be added to the denominator. This process will provide the most conservative calculation of 90/10, as it does not include any Title IV stipends as a reduction to the numerator or denominator.