UNITED STATES DEPARTMENT OF EDUCATION
WASHINGTON, D.C. 20202

IN THE MATTER OF

HI-TECH INSTITUTE OF HAIR DESIGN,

Respondent.

Docket No. 92-129-SA

Student Financial
Assistance Proceeding

Appearances:
Jim Conley, Esq., of San Antonio, Texas, for the Respondent.

Howard D. Sorensen, Esq., of Washington, D.C., Office of the General Counsel, United States Department of Education, for the Office of Student Financial Assistance.

Before:
Judge Ernest C. Canellos

DECISION

Hi-Tech Institute of Hair Design (Hi-Tech), formerly Rickerson Beauty Academy, is owned and operated by Rickerson Care, Inc. (Rickerson).1 At one time, Hi-Tech offered cosmetology training at four campuses in San Antonio, Texas, and at a fifth location in Beaumont, Texas. In 1991, one of the San Antonio campuses and the Beaumont campus closed. Rickerson has since filed for reorganization under Chapter 11.

Hi-Tech, accredited by the National Accrediting Commission of Cosmetology Arts and Sciences and licensed by the Texas Cosmetology Commission, participated in the Pell Grant, Supplemental Educational Opportunity Grant (SEOG), and the College Work Study (CWS) programs, as well as the Guaranteed Student Loan (GSL),2 Perkins Loan, Supplemental Loans for Students (SLS), and Parent Loans for Undergraduate Students (PLUS) loan programs. These student financial assistance programs are authorized under Title IV of the Higher Education Act of 1965, as amended (Title IV), and administered by the Office of Student Financial Assistance Programs (SFAP) of the United States Department of Education (ED).

Between April and July 1991, ED's Dallas Regional Office of the Inspector General conducted an audit review of all Hi-Tech schools. The final audit report, issued on January 23, 1992, found that Hi-Tech had improperly administered Title IV student financial assistance programs during the period from July 1, 1987, through March 31, 1991. 3 Specifically, the auditors determined that Hi-Tech had retained Title IV funds to which it was not entitled (Finding #1) and disbursed

student financial assistance funds to students who may not have been eligible under Title IV regulations (Finding #2).

ED issued a final program determination letter for the audit findings on September 17, 1992, assessing Hi-Tech's total liability at $932, 809. 4 Hi-Tech exercised its right to a timely appeal of the audit determination pursuant to 34 CFR § 668.111 et seq.

DISCUSSION

Hi-Tech set forth its arguments in a letter dated February 27, 1993, from Mr. James A. Rickerson, Jr., to Mr. James T. O'Neill of ED's Office of the General Counsel. 5 In that letter-brief, Hi-Tech contests ED's determination of liability and cites the auditors for misconduct and misapplication of federal regulations. Subsequently, Hi-Tech acknowledged liability in the amount of $70,040.

The regulations governing this proceeding place the burden of proof on the institution requesting a review of the audit determination. 34 CFR § 668.116(d). Pursuant to the rules, the burden is on the institution to show the following: (1) that expenditures questioned or disallowed were proper; and (2) that the institution complied with program requirements. 34 CFR § 668.116(d). Hi-Tech's assertions must be measured against this standard.

Finding #1

ED determined that Hi-Tech, by not making refunds as required, owes $757,524 for improperly retained Title IV funds. Total liability was calculated as follows: $112,587 owed to ED for ineligible Pell, SEOG, and CWS funds disbursed; $596,903 in GSL liability, including interest, owed to lenders; $12,494 owed to ED for interest and special allowances on late refunds and overpayments; and $35,540 owed to GSL and SLS lenders for students whose education was paid for by the Department of Labor's Job Training Partnership Act (JTPA). The program determination letter additionally requires Hi-Tech to determine and return all overpayments and refunds owed after March 31, 1991; to establish procedures to assure that overpayments do not occur and that refunds are paid promptly; and to provide surety equal to the average amount of unearned tuition.

Hi-Tech refutes the auditor's determination of liability under Finding #1, charging the following: (1) the auditors mistakenly rejected Hi-Tech's policy of using available hours in the calculation of refunds and overpayments; (2) the statistical method used by auditors resulted in an overstatement of liability; (3) the auditors used guaranteed loan amounts rather than disbursed amounts in their calculations; and, (4) the school should not be liable for the $128,226 in Federal funds procured through the misconduct of former employees. Hi-Tech has agreed to implement all additional recommendations, but objects to the requirement of surety.

(1) Use of Available Hours in Calculating Overpayments and Refunds

Hi-Tech maintains that its use of available hours in calculating refunds was sanctioned by its nationally recognized accrediting agency and, therefore, should be deemed "fair and equitable,"

as required by 34 CFR § 682.606 (b) (1). Under Hi-Tech's policy, student refunds were based on the number of hours available to the student, rather than the actual hours completed by the student. Thus, when a student withdrew, Hi-Tech would retain a portion of the tuition corresponding to the number of clock hours available to that student during their period of enrollment, even if the number of clock hours attended by that student was significantly less.

Similarly, Hi-Tech considered a student eligible for a second disbursement of Title IV funds as soon as he or she was enrolled for 750 clock hours (one half of the 1500 hour academic year 6), regardless of how many clock hours that student had actually completed. Under the Pell, SEOG, and Perkins programs, if a student withdraws or drops out before the first day of classes in a payment period, a school must return all student financial assistance paid to that student for that payment period. 34 CFR § 668.21 (a) (l). Pell regulations define payment periods based on completed hours. For a clock hour institution, "the first payment period is the period of time in which the student completes the first half of his or her academic year (in credit or clock hours)." 34 CFR § 690.3 (b) (1) (i) (emphasis added). The same payment period concept is applied to GSL, PLUS and SLS program refunds. 34 CFR § 668.22(c). Taken in concert, these regulations reject the use of available hours in calculating overpayments.

Hi-Tech also used the available hours policy in calculating its pro rata refund. GSL refund regulations provide for the application of a pro rata refund rate when a school's cohort default rate exceeds 30 percent. In such cases, the pro rata calculation supersedes the school's own refund policy for those students who have not completed more than six months, or more than half, of their program. 7 34 CFR § 682.606 (b) (2). For schools operating as clock hour institutions, the pro rata refund is measured by dividing the total number of clock hours for a particular enrollment period by the number of clock hours "remaining to be completed" by the student. 34 CFR § 682.606(c) (3).

I find no basis for Hi-Tech's use of available hours in calculating overpayments and pro rata refunds. Furthermore, there is no showing on the record to support Hi-Tech's allegations that the auditors erroneously applied the pro rata refund rate to the entire audit period; or that they failed to recognize that the regulations bringing GSL refunds under a payment period concept became effective in November 1988.

(2) Estimation of Liability Through Statistical Extension

Hi-Tech's primary objection in this regard is that the auditors overstated liability by factoring sample liability to a universe of 890, when in fact the universe was determined to be 853. To estimate Hi-Tech's liability for overpayments and refunds for students who withdrew from school prior to completing their course of study, the auditors used a random sampling technique. According to the audit report and working papers, the auditors randomly selected a sample of 89 students from a universe of 890 students. 8 The 890 were identified by the Texas Cosmetology Commission as having withdrawn from a Hi-Tech school prior to completion of their program.

After the sample was compiled, the auditors ascertained that 37 students from the original list had withdrawn from more than one Hi-Tech school. This double-counting effectively reduced the number of students who had withdrawn from Hi-Tech prior to completion of their program

from 890 to 853. According to the auditors, however, Hi-Tech could not locate the files for four of the 89 students in the sample, none of whom received any Federal student financial assistance. The auditors consequently eliminated those four students from the sample for projection purposes, thereby maintaining a sample size of one in ten (85 out of 853). For reporting purposes, however, the auditors refer to the sample as 89 out of 890.

Hi-Tech's argument is not without merit. The auditor's "solution" to the reduction in the size of the universe was to eliminate from the sample four students who did not receive federal financial assistance. The auditors justify eliminating those four students by virtue of the fact that Hi-Tech could not locate their files. However, the auditors assign all federal financial assistance received by two other students for whom no files could be located as an overpayment. Therefore, full liability for the two students who had received federal funds was extended to the full universe, whereas the absence of liability attributable to the four students who did not receive any federal funds was not factored into the estimate of total liability. Clearly, this method has the potential of frustrating the accuracy of the statistical projection.

I am not convinced, however, of the need to entirely discard the audit results. The erroneous statistical extension does not affect the accuracy of the liability calculated for the students included in the sample. Moreover, the final audit report gave Hi-Tech the option of refunding the amount owed for the students in the sample, and recalculating and remitting the actual amounts owed for the remainder of the students. At the hearing, I questioned Hi-Tech's Counsel as to why they had not availed themselves of this opportunity. Counsel responded that Hi-Tech had conducted its own review, based on its own interpretation of the regulations, and determined that a total liability of $70,040 existed. Counsel additionally proffered the results of an unsigned draft audit report allegedly conducted by an independent auditor as part of Rickerson's Chapter 11 proceeding. These submissions are not dispositive. Hi-Tech's determination of liability reflects its misapplication of federal regulations. The audit report is in draft form and cannot be considered in these proceedings.

I find that Hi-Tech has not availed itself of the option to calculate the liability for the students not included in the sample, and therefore, must remit the amount determined by statistical projection. However, the extension of sample liability should be consistent with the actual population of 853 students. Before ascertaining projected population liability based on an appropriate statistical extension, I will consider Hi-Tech's contention with regard to the use of guaranteed loan amounts in calculating sample liability.

(3) Use of Guaranteed Loan Amounts in Calculating Overpayments and Refunds

In their letter-brief, Hi-Tech cites three students for whom the auditors used loan amounts guaranteed by ED, rather than amounts received by students, in calculating overpayments and refunds. This practice is clearly inconsistent with Title IV regulations. For example, an overpayment is based on the amount of funds paid to the student for a particular payment period. 34 CFR § 668.21(a) (emphasis added). Similarly, an institutional refund is defined as the difference between the amount paid to a student and the amount retained by the institution. 34 CFR § 668.22 (a) (2). (emphasis added). Moreover, the regulations governing the distribution of refunds among Title IV programs specify that the amount of an overpayment or refund allocated

to a specific Title IV program may not exceed the amount that a student received from that program. 34 CFR § 668.22 (e) (3).

To meet my responsibility to ensure fairness in this proceeding, I must assess the credibility of Hi-Tech's claims within the context of the school's burden of proof. Under this standard, the school has the ultimate burden of convincing the factfinder that the school's arguments are "more compelling." In the Matter of Sinclair Community college, Dkt. No. 89-21-S, U.S. Dep't of Educ. (Decision of the Secretary) (Sept. 26, 1991), at p. 5. In this regard, the school's assertion that the auditors used guaranteed loan amounts in calculating overpayments and refunds is not inherently inconsistent with the record. According to the audit determination letter, the auditors used the "net amounts of student loans guaranteed by the Department of Education" in their review. Moreover, SFAP has not taken the opportunity to dispute Hi-Tech's claim with respect to these three students in any of its subsequent submissions to this tribunal. An additional consideration turns on the limited availability of evidence to show that funds were not received or cancelled. In light of the above, I am inclined to accept Hi- Tech's claim with regard to the three aforementioned students. Accordingly, sample liability is reduced by $4,905, to $48,695.

Applying an appropriate statistical extension to the reduced determination of sample liability ($48,695) results in an estimate for population liability of $467,000. 9 Hi-Tech's liability for overpayments and refunds for students who withdrew from Hi-Tech before completing their program is thereby reduced from $536,000 to $467,000.

Based on the above finding of liability, the amount of special allowances and interest owing to ED and lenders shall be adjusted accordingly.

(4) Liability for Employees Misconduct

During the audit review, auditors discovered that a number of the school's financial aid officers collected Title IV funds for students who were not enrolled, were enrolled but not attending classes, or for whom the academy had no records. In total, Hi-Tech disbursed $128,266 to five employees and nine of their family members and friends. Throughout this proceeding, ED has acknowledged that these funds were procured through the misconduct of Hi-Tech employees.

Hi-Tech argues that it cannot be held responsible for the criminal conduct of its former employees and that it should be excused from any obligation to repay these funds. Title IV regulations, however, bind Hi-Tech as a fiduciary, requiring the "highest standard of care and diligence in administering the programs and accounting to the Secretary." 34 CFR § 668.82(b). In addition, Hi-Tech is subject to the civil liability arising from the conduct of its agents acting within the scope of their duties. Restatement (Second) of Agency, § 261. Hi-Tech is thus liable for the full amount of $128,266.

Finding #2

The auditors determined that Hi-Tech disbursed an estimated $170,046 in student financial assistance funds to students who may not have been eligible for participation in the Title IV programs. For purposes of Title IV eligibility, students must have a high school diploma or its

recognized equivalent. 34 CFR § 668.7 (a) (3) (i). Schools are required to maintain records regarding the educational qualifications of all students. 34 CFR § 668.23 (f) (2).

The audit revealed that files for eleven of the students sampled did not contain proper documentation regarding high school completion. Records further established that $17,046 in Title IV funds were disbursed to those eleven students during the audit period. Accordingly, the auditors used the statistical extension method discussed above to estimate total liability for Finding #2 at $170,460.

Hi-Tech contends that it submitted documentation supporting the eligibility of the eleven students sometime after the initial audit report, but before the final audit report was issued. SFAP, however, maintains that Hi-Tech has not documented eligibility. In response to my inquiry at the hearing, and in SFAP's Post-Hearing Brief, counsel expressed SFAP's willingness to review such documentation in the event that it exists. In fact, it appears from the exhibits attached to SFAP's Reply Brief, that documents for all but two of the eleven students were appended to a letter, dated November 12, 1992, from Mr. James A. Rickerson, Jr. to Ms. Victoria Edwards, Acting Chief of the Audit Resolution Branch of the Institutional Monitoring Division. The documentation consists primarily of notarized affidavits, signed by the students, proclaiming completion of the 12th grade or high school equivalency. In a few cases, supporting documents, such as a high school transcript or GED certificate, are also included.

Based on the fact that these documents were introduced into the record as part of SFAP's submissions, I can only interpret their assertion that Hi-Tech has not documented eligibility to mean that SFAP does not consider self-certification of eligibility sufficient for this purpose. Neither ED policy nor the Title IV regulations, however, require that a school obtain a copy of the student's diploma. To comply with the law and regulations governing the Title IV student financial assistance programs, the institution may rely on a certification by the student as to the existence of such diploma. In the Matter of Empire Technical School, Dkt. No. 91-53-SF, U.S. Dep't of Education (December 13, 1993).

I find the affidavits of high school completion or its recognized equivalent sufficient to satisfy the requirements of 34 CFR § § 668.7(a)(3)(i) and 668.23 (f) (2). Additionally, the two students for whom documentation of high school completion is not provided on the record did not receive Federal student financial assistance. Therefore, I find that Hi-Tech is not liable for the amounts cited under this Finding.

FINDINGS

I FIND the following:

The auditors conducted a reasonable audit review within the parameters established under federal guidelines;

Hi-Tech failed to properly calculate overpayments and refunds for students who withdrew from Hi-Tech prior to completing their program;

The auditors misstated total liability for overpayments and refunds by using an erroneous statistical extension of sample liability;

The auditors erred in using the guaranteed loan amounts rather than the loan amounts disbursed to three students included in the sample;

Hi-Tech is liable as a fiduciary and as a principal for the Title IV funds disbursed to persons who were not enrolled, who were enrolled but not attending classes, and for whom the school had no records;

Hi-Tech is responsible for $35,540 in GSL funds disbursed for students whose education was paid for by the JTPA;

Hi-Tech is responsible for an adjusted amount in special allowances and interest on the liability estimated herein;

Hi-Tech's liability under Finding #1 totals $630,806, and an adjusted amount for special allowances and interest to be determined;

Hi-Tech provided sufficient evidence of high school completion for nine of the eleven students whom the auditors considered ineligible for Title IV funds, and the remaining two students received no Federal student financial assistance;

Hi-Tech has no liability under Finding #2.

ORDER

On the basis of the foregoing, it is hereby --

ORDERED, that Hi-Tech School of Hair Design, repay to the United States Department of Education and the appropriate lenders the sum of $630,806, plus an adjusted amount for special allowances and interest to be determined in accordance with this Decision.

Ernest C. Canellos

Issued: July 14, 1994
Washington, D.C.

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1 For purposes of clarity, this decision will refer to Respondent as the Hi-Tech Institute of Hair Design (Hi-Tech).While there was some initial confusion regarding the proper name for the Respondent, I consider the names to be interchangeable.

2 The GSL and SLS programs are now called the Federal Family Education Loan program (FFEL).

3 The program determination misstated the completion date of the audit period as March 31, 1990. It is clear from a preponderance of the documents on record, however, that the correct date is March 31, 1991.

4 Throughout the audit determination letter, ED cites various figures indicating Hi-Tech's costs. Significant discrepancies exist between these capsulated figures and the sum of enumerated liabilities listed under the heading "Program Determination" under each Finding. I regard the sum of the enumerated liabilities as total liability.

5 On May 10, 1993, I issued an order denying SFAP's motion for default judgment against Hi-Tech and accepting the February 27, 1993 letter as a brief timely filed.

6 Despite Hi-Tech's claim that it operated as a 900 clock hour institution, a copy of a Hi-Tech Enrollment Agreement reveals that a complete course at Hi-Tech consisted of 1500 clock hours. Hi-Tech provides no additional documentation to support a finding to the contrary.

7 According to SFAP, ED notified Hi-Tech early in 1990 that its fiscal year 1988 default rate exceeded 30 percent. Pursuant to federal regulations requiring notice, the pro rata refund rate became effective in June 1990.

8 ED's program determination letter cites a universe of 196 students. This error apparently added to the confusion regarding the auditors' sample method. It is clear from the record, however, that the auditors initially selected the sample from a total population of 890 students.

9 To obtain an appropriate projection of liability based on the determination of sample liability, I multiplied total sample liability to a universe of 853 students.