

IN THE MATTER OF KATIE'S SCHOOL OF BEAUTY CULTURE & BARBERING
Respondent.

Docket No. 90-68-ST
Student Financial Assistance Proceeding

DECISION

Appearances: Jerome J. Pellerin, Esq. of New Orleans, Louisiana, for the Respondent

Paula T. Yellman, Esq. of Washington, D.C., Office of the General Counsel, United States
Department of Education for the Office of Student Financial Assistance

Before: Judge Allan C. Lewis

This is an action initiated by the United States Department of Education (ED) to terminate the eligibility of Katie's School of Beauty Culture & Barbering (Katie) to participate in the student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, and to impose a fine of \$175,000. [See footnote 1 1/](#) ED alleges that Katie is not a financially responsible institution under 34 C.F.R. § 668.13(c) (1990) and failed to submit two biennial non-Federal audits. Therefore, according to ED, Katie may not continue to participate in the student financial assistance programs. Based upon the findings of fact and conclusions of law, *infra*, Katie's eligibility to participate in Title IV programs is terminated and a civil fine is imposed in the amount of \$3,000.

I. FINDINGS OF FACT

Katie is a small institution offering courses in cosmetology and barbering located at 2100 Dryades Street, New Orleans, Louisiana. [See footnote 2 2/](#) It has a student population of approximately 50 students and its academic year is 900 clock hours. It is operated as a sole proprietorship. [See footnote 3 3/](#) As of May 1986 Katie was authorized to participate in the following student loan programs: Pell Grant, Stafford Loan, PLUS and Supplemental Loans for Students.

Katie received and disbursed Pell Grant funds as follows:

Award Year	Amount
1986	\$ 13,825
1987	52,545
1988	58,060
1989	106,300
1990	71,388
1991	38,450

On November 8, 1989, ED notified Katie that it had no record of receiving audit reports for Katie's 1986 and 1987 Pell Grant program.

By letter dated November 20, 1989, Katie contracted with a local CPA to conduct the biennial audits for 1986 and 1987 and 1988 and 1989 which were overdue.

In the program participation agreements executed by Katie with ED over the years, the agreements require Katie to comply with the regulations regarding the submission of non-Federal audits. Accordingly, Katie was required to submit audits for the following award years and submitted audits, which were also acceptable to ED, as follows:[See footnote 4 4/](#)

Award Year Due Date Submitted

1986 3/31/88 11/20/90

1987 3/31/88 11/20/90

1988 3/31/90[See footnote 5 5/](#) 11/20/90

1989 1/31/90 11/20/90

On January 29, 1990, the Institution and Lender Certification Branch of the Division of Eligibility and Certification of ED requested Katie to post an irrevocable letter of credit in the amount of \$35,000 in order for Katie to continue to participate in the Pell Grant program and to obtain final approval to participate in the Campus-Based program. ED also requested an audited or certified June 30, 1990 financial statement from Katie as soon as possible but not later than December 31, 1990, "so that a further review can be conducted."

On March 12, 1990, Katie responded that, due to the death of the owner, the estate has to go through succession and that the Chief Fiscal Officer/Administrator, Ms. Helen Savare, did not have authority to apply for a letter of credit. Katie requested that the letter of credit be waived for the award year ending 1991. In addition, Katie enclosed a financial statement for the twelve month period ending June 31, 1988, as requested by ED.

On April 24, 1990, the Institution and Lender Certification Branch of the Division of Eligibility and Certification of ED denied Katie's request for a waiver of the letter of credit--

In view of the letters [of March 12 and 30, 1990] and the interim December 31, 1989 financial statement submitted, we do not see any substantial change in the School's financial condition. Therefore, we are unable to satisfy your request to waive our letter of credit requirement.

Accordingly, ED reiterated its request for a \$35,000 letter of credit in order for Katie to continue to participate in the Pell Grant program and to participate in the Campus-Based program.

On June 4, 1990, the Institution and Lender Certification Branch of the Division of Eligibility and Certification of ED wrote Katie, again, that its failure to provide the \$35,000 letter of credit within 30 days will result in two actions. Katie would be rejected as a potential participant in the Campus-Based program. Its case would also be referred to the Program Compliance Branch with a recommendation that it take adverse administrative action against the school.

As of the date of the initial decision in this case, Katie has not submitted the letter of credit requested by ED.

On August 28, 1990, the Office of Student Financial Assistance of ED notified Katie that it intended to terminate its eligibility to participate in the Title IV loan programs and to fine it \$175,000. The proposed grounds for termination were its lack of financial responsibility (as reflected by its financial statement for the calendar year 1989 which indicated a net worth of (\$33,711) and net working capital of (\$16,540)) and its failure to submit biennial non-Federal audits for the award years ending 1987 and 1988 and 1989. ED also proposed a fine of \$175,000 for the above purported violations. Other than this generalized statement, ED did not specify the manner in which the amount of the proposed fine was determined.

In its correspondence with Katie, ED did not request a performance bond or other documents to demonstrate the financial responsibility of Katie in lieu of a letter of credit. During this period, Katie did not offer to submit a performance bond or other documents to demonstrate its financial responsibility in lieu of a letter of credit.

ED did not request in its correspondence with Katie, and Katie did not submit to ED, any financial information relating to the personal assets of Ms. Chapman held by her estate.

The attorney representing the estate of Ms. Chapman in the succession proceedings is unwilling to permit the assets of the estate to be used to secure any future or current obligations of Katie to the Department. The attorney representing Katie in this proceeding is not the attorney for the estate.

Katie utilizes the cash basis method of accounting and maintains its books and records on a calendar year basis. Accordingly, it issues its financial statements on a calendar year basis.

Katie's non-audited financial statement for the calendar year 1988, dated January 30, 1989, included a balance sheet reflecting the following:

Assets

Current Assets (cash) \$ 7,931
Fixed Assets (furn & equip) 14,889
Total Assets \$ 22,820

.....

Liabilities and Equity

Current Liabilities (taxes) \$ 5,515
L-T Liabilities (note payable) -----
Total Liabilities 5,515

Equity

Dividends 100

Retained Earnings 8,212
Current Inc. (loss) 9,093
Total Equity 17,305
Total Liab. & Equity \$ 22,820
.....

It should be noted that the above balance sheet is incorrect as it fails to disclose a long-term liability reflecting the \$33,000 note payable to ED. Accordingly, if an adjustment was made for the note payable, the balance sheet would reflect a negative net worth.

The income statement for the calendar year 1988 reported the following:

Sales \$ 77,043
Operating Expenses 67,950
Net Income \$ 9,093
.....

As submitted to ED, Katie's non-audited financial statement for the twelve month period ending June 30, 1988, dated June 28, 1989, included a balance sheet reflecting the following:

Assets

Current Assets (cash) \$ 1,741
Fixed Assets (equipment) 14,088
Total Assets \$ 15,829

Liabilities and Equity

Current Liabilities (taxes) \$ 13,500
L-T Liabilities (note payable) 33,000
Total Liabilities 46,500

Equity

Retained Earnings (30,669)
Earnings (Loss) -----
Total Equity (30,669)
Total Liab. & Equity \$ 15,830
.....

The balance sheet reflects a negative net working capital of \$11,759 which represents the difference between the current assets, i.e. \$1,741, and the current liabilities, i.e. \$13,500. The ratio of current assets to current liabilities is 1:7.7.

The income statement for the twelve month period ending June 30, 1988, reported the following:

Sales \$ 77,266
Operating Expenses 103,637
Net Income \$ (26,371)

.....

In note 1 attached to the financial statement for the twelve month period ending June 30, 1989, which was prepared by a CPA, it states that "the accounting records . . . are maintained on the accrual basis of accounting, accordingly revenues are recognized when earned and expenses are recorded when incurred."

As submitted to ED on March 12, 1990, Katie's non-audited financial statement for the calendar year 1989, dated February 5, 1990, included a balance sheet reflecting the following:

Assets

Current Assets (cash) \$ 1,517
Fixed Assets (furn & equip) 14,089
Total Assets \$ 15,606

.....

Liabilities and Equity

Current Liabilities (taxes) \$ 18,057
L-T Liabilities (note payable) 31,260
Total Liabilities 49,307

Equity

Retained Earnings (30,060)
Current Inc. (loss) (3,651)
Total Equity (33,711)
Total Liab. & Equity \$ 15,606

.....

The balance sheet reflects a negative net working capital of \$16,540, which represents the difference between the current assets, i.e. \$1,517, and the current liabilities, i.e. \$18,057. The ratio of current assets to current liabilities is 1:11.9.

The income statement for the calendar year 1989 reported the following:

Sales \$ 124,170
Operating Expenses 127,822
Net Income \$ (3,651)

.....

The 1989 calendar year financial statement did not reflect the ownership of any real property.

The building in which Katie conducts its business is located at 2100 Dryades Street, New Orleans, Louisiana, and was owned by Ms. Chapman. It is presently an asset in her estate. In 1988, this property was valued in the amount of \$175,000 in the final account of Ms. Chapman's interdiction proceedings submitted by Ms. Helen Savare, the curatrix. Ms. Chapman's remaining property was valued at \$32,000 which included cash in the amount of \$12,000.

In her 1982 and 1983 Federal income tax returns filed by Ms. Chapman, she reported that Katie employed the cash basis method of accounting. In schedule C, the profit or (loss) from business form for Katie, she claimed depreciation deductions only for capital improvements to the building located at 2100 Dryades Street, such as a roof. These improvements were made as early as 1968. No depreciation expense was claimed based on the building. These returns were prepared by a law firm or a CPA firm. The failure to claim depreciation on the building in her tax returns indicates that the building was fully depreciated by this time. Ms. Chapman reported a net profit of \$11,500 for 1982 and a loss of \$4,500 for 1983.

In April 1988, ED completed a program review for a period prior to November 7, 1987. As a result of program deficiencies and violations, ED found Katie liable for \$33,853. The parties executed a repayment agreement which obligates Katie to make monthly payments until June 1994. The remaining amount due under this note is reflected as a long-term liability in the amount of \$31,260 in the financial statement for the calendar year 1989.

In the event of a finding of liability in the administration of any program under Title IV of the Higher Education Act of 1965, as amended, for an institution owned and operated as a sole proprietorship, the owner would be held personally liable for the obligation due.

II. OPINION

In this action, ED seeks to terminate the eligibility of Katie to participate in the student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, and to impose a fine of \$175,000. On August 28, 1990, ED notified Katie that, as of September 21, 1990, it intended to terminate the institution from participation in the Title IV programs and to fine the institution. On September 18, 1990, and within the period specified by 34 C.F.R. § 668.86(b)(1)(iii) (1990) to request a hearing on the record, Katie filed its request for a hearing. [See footnote 6 6/](#) Accordingly, jurisdiction is proper.

A. Termination Issue. ED is authorized under Section 487(c)(1)(D) of the Higher Education Act of 1965, as amended by Section 451.(a) of the Education Amendments of 1980, Pub. L. 96-374, 94 Stat. 1367 (to be codified at 20 U.S.C. § 1094(c)(1)(D)), to prescribe regulations for--

(D) the limitation, suspension, or termination of the eligibility for any program under this subchapter . . . of any otherwise eligible institution, or the imposition of a civil penalty under paragraph (2)(B) whenever the Secretary has determined, after reasonable notice and opportunity for hearing on the record, that such institution has violated or failed to carry out any provision of this subchapter . . . or any regulation prescribed under this subchapter

Pursuant to this authority, the ED promulgated 34 C.F.R. § 668.86(a) which provides that--

the eligibility of an institution to participate in any or all Title IV, HEA programs [may be limited or terminated] if the institution violates any provision of Title IV of the HEA or any regulation or agreement implementing that Title.

ED proposes to terminate Katie's eligibility to participate in the student loan programs due to its lack of financial responsibility under 34 C.F.R. § 668.13 and its failure to submit biennial non-Federal audits for the award years ending 1987, 1988, and 1989.

In order to begin and to continue to participate in the student loan programs, an institution must demonstrate to ED that it is financially responsible under the standards established in 34 C.F.R. § 668.13. 34 C.F.R. § 668.13(a). In general, ED considers an institution financially responsible if, inter alia, it is able to "meet all of its financial obligations." 34 C.F.R. § 668.13(b)(3). However, an institution is not considered financially responsible under 34 C.F.R. § 668.13(c) if--

(1) Under its basis of accounting, it--

.....
(ii) Had, for its latest fiscal year, a deficit net worth. A deficit net worth occurs when the institution's liabilities exceeds its assets;

(2) Under an accrual basis of accounting, it had, at the end of its latest fiscal year, a ratio of current assets to current liabilities of less than 1:1;

The initial controversy between the parties is whether Katie had a deficit net worth under the above regulation for the calendar year ended December 31, 1989--its latest fiscal year at the time the present controversy arose. Its balance sheet for this period, as submitted to ED, reflects a deficit net worth in the amount of \$33,711. Katie asserts, however, that a significant asset--the building in which the school conducts its business--was omitted from the financial statement. In view of the building's nexus to the business, Katie argues that the unencumbered fair market value of the building, i.e. \$175,000, should be reflected in the financial statement. [See footnote 7 7/](#) If Katie's position is correct, then it will have a positive net worth and be considered financially responsible under the above regulation.

ED argues, in effect, that the school may not correct its purported inaccurate financial statement. In ED's view, the institution is apparently limited to the evidence presented by it to the Department during the administrative consideration of the matter at hand and therefore the institution may not correct its purported inaccurate financial statement in the present proceeding. This is a proceeding, however, whose purpose is to ascertain the correctness of the proposed Departmental action. Therefore, the tribunal is concerned with determining the facts, not inaccurate facts, in order to assist it in its decision making function as well as to enable the Secretary to make an informed decision in the event one or both of the parties appeals the initial decision issued by the tribunal. Accordingly, whether an asset was omitted from the balance sheet of Katie's is a matter properly before this tribunal.

Next, ED disputes whether the building was used prior to or during 1989 in the conduct of Katie's business on the theory that there is no evidence to support this fact. The facts reflect otherwise. The program participation agreements executed before and after the fiscal year in question identify the building as the address of the institution. In schedule C, profit or (loss) from business form attached to Ms. Chapman's Federal income tax returns for 1982 and 1983, the

building is identified as the place of Katie's business. In addition, Ms. Chapman reported a depreciation deduction in this form for various improvements to the building which were made as early as 1968. A depreciation deduction is allowed only for assets used in a trade or business or held for the production of income. 26 U.S.C. § 167(a). In light of these facts, it is clear that the building had been directly used in connection with the school for years, including the calendar year 1989.

Since the building was used in the furtherance of the school's business and was omitted from the financial statement, the next issue is the proper amount which should be reflected in the asset side of the balance sheet of the financial statement. Though Katie asserts that the unencumbered fair market value of the building should be reflected in the financial statements, it does not propose a specific value. It may be inferred, however, that Katie suggests a value in excess of \$34,000--the amount necessary for Katie to achieve a positive net worth.

ED argues that the value of the building is unknown during the calendar year 1989 and also it is unknown whether the building was encumbered with a mortgage during this period.

The fair market value of the building in 1989 is not, however, pertinent. Net worth is, for purposes of 34 C.F.R. § 668.13(c)(1)(ii), determined under the basis of accounting adopted by the school. Katie utilizes the cash basis method of accounting. Under this method--

[i]t is [the] generally accepted [accounting] practice to record and report buildings and equipment at their historical cost. Cost means the amount of the purchase consideration . . . at the time of acquisition

The cost principle is that assets are to be recorded initially at cost and kept at cost until realization takes place. In the case of fixed assets, depreciation is recognized in the accounts but is based on historical cost. Cost less depreciation is the valuation basis generally adhered to throughout the life of each asset.

S. Davidson, Handbook of Modern Accounting (McGraw-Hill 1970) at 17-17.

Thus, the appropriate figure for the building in the financial statement for the calendar year 1989 is not the fair market value of the building as of this date. Rather, it is the historical cost of the building reduced by the depreciation previously taken.

The figure which represents the historical cost of Ms. Chapman's building reduced by the depreciation previously taken is insufficient to produce a positive net worth. The building has been fully depreciated apparently and, therefore, little or nothing remains to be included as an asset in Katie's 1989 balance sheet. Katie asserts in its brief that Ms. Chapman depreciated the building and recognized that expense against the revenues generated from the operation of Katie's as reflected in her 1982 and 1983 Federal income tax returns. These returns were prepared by either a CPA firm or a law firm. They reflect all legally permissible deductions, including depreciation, in order to minimize Ms. Chapman's tax liability. The returns reflect depreciation expenses based only on the improvements to the building with the earliest improvement made some 14 years previously in 1968. No depreciation expense was claimed based on the building. Inasmuch as buildings are given a useful life in excess of 20 years for

purposes of depreciation under generally accepted accounting principles, the failure to claim depreciation on the building for 1982 and 1983 indicates that Katie's building was acquired many years prior to 1982 and that it was fully depreciated sometime prior to 1982. *Id.* at 18-6. Accordingly, the inclusion of this asset in Katie's balance sheet for the calendar year 1989 does not affect the total value of the assets. Therefore, Katie is considered not financially responsible under 34 C.F.R. § 668.13(c).

ED also asserts that Katie is not financially responsible under 34 C.F.R. § 668.13(c)(2) as its current ratio for the calendar year 1989 was less than 1:1. This regulation applies literally, however, only to institutions which utilize the accrual method of accounting. 34 C.F.R. § 668.13(c)(2).

Based on the record, Katie employs the cash basis, not the accrual basis, method of accounting. The only evidence in support of the employment of the accrual method of accounting by Katie is note 1 attached to the financial statement for the twelve month period ending June 30, 1989, which was prepared by a CPA. The note states that "the accounting records . . . are maintained on the accrual basis of accounting, accordingly revenues are recognized when earned and expenses are recorded when incurred." The regular financial statement for the calendar year 1989 which was prepared by this CPA is silent on this point.

The evidence supporting the employment of the cash basis method of accounting is more persuasive. Initially, Katie is a small, unsophisticated operation with yearly revenues of approximately \$100,000 or less. While the above financial statement purportedly was prepared under the accrual method, its balance sheet contradicts this fact. The balance sheet does not reflect any accounts receivable or accounts payable (other than taxes)--two items which occur as a matter of course under the accrual basis method of accounting and are not present under the cash basis method of accounting with the exception of an account payable for taxes. [See footnote 8 8/](#) The calendar year 1988 and 1989 financial statements also do not reflect any accounts receivable or accounts payable (other than taxes). Ms. Chapman's 1982 and 1983 Federal income tax returns indicate that Katie was on the cash basis method of accounting. In addition, the June 11, 1990 statement of financial ability signed by Ms. Savare, while only given minor weight here, reflects that Katie was on the cash basis method of accounting.

While the evidence is mixed as to whether Katie is on the cash basis or accrual basis method of accounting, the weight of the evidence supports a finding that Katie utilizes the cash basis method of accounting. Therefore, ED's second argument under 34 C.F.R. § 668.13(c)(2), which is predicated on the employment of the accrual basis method of accounting, is rejected. Thus, Katie is found to be not financially responsible only under 34 C.F.R. § 668.13(c)(1).

ED also seeks to terminate Katie's eligibility to participate in Title IV programs on the ground that Katie failed to submit non-Federal financial and compliance audits of its administration of the Pell Grant program for the award years ending 1987, 1988, and 1989. [See footnote 9 9/](#) An institution which participates in the student loan programs is required to comply with the specific program regulations concerning biennial audits of institutional transactions. 34 C.F.R. § 668.12(a) (1986). Under the Pell Grant program, an institution is required to have an audit performed at least once every two years in accordance with ED's audit guides. [See footnote 10](#)

10/ 34 C.F.R. § 690.84 (1986). For the award year ending 1987, the biennial audit was due within 9 months of the end of the audit period, i.e. by March 31, 1988. 34 C.F.R. §§ 690.84(b)(2) and (c) (1986). For the 1988 and 1989 audit, the due date was January 31, 1990. 34 C.F.R. § 668.23 (c)(4)(ii) (1988).

In the present case, it is stipulated that Katie did not submit the audits for 1987 and for 1988 and 1989 on a timely basis. Katie submitted these audits on November 20, 1990, and, therefore, was 32 months late with respect to the 1987 audit and 10 months late with respect to the 1988 and 1989 audit. Even though Katie submitted these audits, it has still, nonetheless, failed to comply with the regulations requiring a timely submission of the audits.

Where, as here, there are violations of the regulations by the institution in a termination proceeding, it is incumbent upon the tribunal to determine the nature of the appropriate sanctions. In this regard, the Administrative Law Judge may--

issue a decision to fine the institution or impose one or more limitations on the institution rather than terminating its eligibility to participate.

34 C.F.R. § 668.90(a)(2).

As explained below, it is appropriate in the context of this proceeding to order a "teach-out" program of its students by Katie prior to its termination of eligibility to participate in Title IV programs in lieu of an immediate termination of its eligibility. This approach will best serve the interests of all involved, including the students of Katie. [See footnote 11 11/](#)

Initially, a "teach-out" program will enable the students to complete their education without any disruption. Therefore, such an approach will benefit the students.

In view of the acceptable audits submitted by Katie to ED, ED's concern is primarily financial. This concern focuses on whether the institution is able to provide the student services described in its official publications and statements and to administer the Title IV programs properly, including repayments and refunds to the students or their lenders and repayments to ED of liabilities and debts incurred in programs administered by ED. 34 C.F.R. §

668.13(b). ED's interest is protected. Katie's potential liability under a continuation of the Pell Grant program for the short-term is relatively insignificant. Katie's total yearly disbursement of Pell Grant funds was only \$70,000 for the award year ending 1990 and is approximately \$40,000 for the current year. Katie's past earnings record reflects that it operates essentially at a break-even point and thus the continued operation of the business over a relatively short period of time will not significantly affect the cash position of Ms. Chapman's estate.

The estate of Ms. Chapman apparently has one major asset--the building in which the school operates. It was valued at \$175,000 as of February 1988 in the final account filed by the curatrix, Ms. Savare, in the local civil court in New Orleans. [See footnote 12 12/](#) The premise of the cash basis method of accounting, which does not recognize the fair market value of an asset in the balance sheet, such as the building in the instant case, does not effectively portray the true

financial condition of Katie or Ms. Chapman's estate. When the building is factored into the equation, ED has sufficient financial protection to allow a "teach-out" program. This will also provide some flexibility to Ms. Chapman's estate regarding whether to close the school earlier than the end of the teach-out period for, at some point, it appears that the building will have to be sold in order to satisfy the existing \$30,000 obligation to ED which arose as a result of a prior program review or to possibly raise cash.[See footnote 13 13/](#)

ED requests that Katie be placed on reimbursement payment system for the receipt of Pell Grant funds in the event a "teach-out" program is imposed. In its view, the reimbursement payment "would protect the Department and the current students at Katies against a loss of or indeed a waste of Pell Grant funds." Under the reimbursement payment system, ED requires the institution to hire and pay for a CPA or expert in the administration of Title IV programs to certify that the amount requested by the institution for reimbursement is proper. The certification requires extensive information and documentation which the institution provides to the outside party.[See footnote 14 14/](#) The imposition of the reimbursement payment system is not warranted under the present circumstances. Katie's yearly student population is approximately 50 students and, as noted above, its yearly disbursement of Pell Grant funds is quite modest. There have been no allegations in the present proceeding that Katie has diverted loan funds for improper purposes. Given the student population and the cash flow disruption caused by the implementation of the reimbursement payment system by Katie, it would be, without doubt, cost prohibitive in this case. Accordingly, the reimbursement payment system will not be imposed.

B. Fine Issue. In addition to the proposed termination of the eligibility of Katie to participate in the student loan programs, ED also proposes a total civil fine in the amount of \$175,000. Under Section 487(c)(2)(B)(i) of the Higher Education Act of 1965, as amended by Section 451.(a) of the Education Amendments of 1980, Pub. L. 96-374, 94 Stat. 1367 (to be codified at 20 U.S.C. § 1094(c)(2)(B)(i)), ED "may impose a civil penalty upon an institution of not to exceed \$25,000 for each violation or misrepresentation" of any provision of this subchapter or any regulation thereunder.

In *In re Hartford Modern School of Welding*, Dkt No. 90-42-ST, U.S. Dep't of Education (Jan. 31, 1990) at 18, the tribunal held that--

In determining the amount of the fine, 34 C.F.R. § 668.92(a) provides that the Administrative Law Judge and the Secretary "shall take into account . . . [t]he gravity of the violation . . . and [t]he size of the institution." The gravity of the violation reflects the relative degree of the seriousness of the violation vis-a-vis other violations as well as the relative nature and extent of the violation itself. In addition, an imposition of a fine functions as a "punishment of the offender as well as [a] warning to others." In *re Caguas College of Technology and Science*, U.S. Dep't of Education (Oct. 25, 1988) at 10.

In determining the amount of the fines, Katie is a very small institution. Katie had approximately 50 students and disbursed no more than \$107,000 in Pell Grant funds in the last several years. There are proprietary institutions substantially larger than Katie in terms of the total amount of loans received annually by their students, e.g. students received approximately \$12 million in student loans in *In re Trend Colleges, Inc.*, Dkt. No. 90-56-ST, U.S. Dep't of Education (case pending before the tribunal), \$7 million in student loans in *In re Deloux Schools of*

Cosmetology, Dkt. No. 89- 59-S, U.S. Dep't of Education (Oct. 30, 1990) at 52, and \$1.2 million in student loans in *In re Hartford Modern School of Welding*.

ED proposed fines in the amount of \$175,000 in its notice of termination and fine. The notice does not specify the manner in which the amount of the fine was determined other than to state that ED "intends to fine the School \$175,000 based on the violations set forth in Part I of this letter." The alleged Part I violations were Katie's failure to file two biennial audits and its failure to be financially responsible.

In brief, ED concedes that its original proposed fine was excessive. However, the circumstances have changed. The two biennial audits have now been submitted and they are acceptable to ED. ED now proposes a fine of \$1,000 for the biennial audit submitted 10 months late and a fine of \$2,000 for the biennial audit submitted 32 months late. In addition, ED proposes a fine of \$1,000 for Katie's failure to comply with the financial responsibility regulations.

In light of the termination of Katie's eligibility to participate in Title IV programs, *supra*, it is inappropriate to fine Katie \$1,000 for its failure to remain financially responsible. Termination is a severe penalty and no purpose would be served by imposing a financial penalty in addition to the termination. In addition, the imposition of termination as well as the subsequent submission of the two biennial audits cast a different perspective on the fines originally proposed due to Katie's failure to submit two biennial audits. In this context, fines of \$1,000 and \$2,000 for the submission of a biennial audit 10 months and 32 months late, respectively, are appropriate. Thus, Katie is fined a total of \$3,000 for its violations.

III. ORDER

On the basis of the foregoing findings of fact and conclusions of law, and the proceedings herein, it is hereby--

ORDERED, that the eligibility of Katie to participate in the student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, is terminated as of the date specified in the terms of the "teach-out" program, *supra*; and it is further

ORDERED, that Katie immediately and in the manner provided by law pay fines in the total amount of \$3,000 to the United States Department of Education.

.....
Allan C. Lewis
Administrative Law Judge

Issued: March 27, 1991
Washington, D.C.

Footnote: 1 / More specifically, ED seeks to terminate Katie from participating in the Pell Grant, Supplemental Educational Opportunity Grant, Perkins Loan, and College Work-Study

programs, and the Guaranteed Student Loan programs which includes the Stafford Loan, PLUS, and Supplemental Loans for Students programs.

[Footnote: 2](#) 2/ The parties executed a stipulation of fact including exhibits and agreed thereafter to close the record. Accordingly, the hearing was conducted by written submissions and the findings of fact are based solely on the stipulation. 34 C.F.R. § 668.90(a)(4) (1990).

[Footnote: 3](#) 3/ Katie Wickham Chapman was the proprietor of Katie. She was interdicted (put under conservatorship) in June of 1987. On February 2, 1988, she died and her succession is currently pending in the Louisiana Civil District Court for the Parish of New Orleans. A will has been presented for administration the terms of which are unknown but which, according to the parties' stipulation, could affect the availability of the assets of the estate to secure any current or future obligations of Katie to ED. Since June of 1987, Katie has been operated by Helen N. Savare.

[Footnote: 4](#) 4/ While apparently authorized to participate in several loan programs, it appears that Katie only utilized the Pell Grant program.

[Footnote: 5](#) 5/ This date was stipulated by the parties.

[Footnote: 6](#) 6/ All regulations are cited in their current form unless otherwise noted.

[Footnote: 7](#) 7/ The inclusion of this asset in the balance sheet of the financial statement may also be argued on a broader basis, namely that ED should consider all assets and liabilities of the school-owner where the school is operated as a sole proprietorship. The foundation for this argument is that ED looks to all assets of the sole proprietor, whether personal or associated with the school, to satisfy any liability arising out of the administration of Title IV programs. In view of the nexus of the building to the business in the instant case, this issue need not be addressed here.

[Footnote: 8](#) 8/ This conclusion was apparently also reached by an unknown ED employee who reviewed this document as reflected by the comment, "on cash basis . . .," written on the face of the financial statement.

[Footnote: 9](#) 9/ In its brief, ED also asserts a violation for Katie's failure to file an audit for the award year ending 1986. However, this ground was not included in ED's notice of termination and fine. Absent such an inclusion, this matter is not properly before the tribunal. 34 C.F.R. § 668(b)(1)(i); *In re Hartford Modern School of Welding*, Dkt. No. 90-42-ST, U.S. Dep't of Education (Jan. 31, 1991) at 9 n.9.

[Footnote: 10](#) 10/ The audit provides an external means of evaluating the accuracy of an institution's determination of students' eligibility, its awarding and disbursing of aid, and its refunds of students' unearned tuition and other costs. *Id.* at 11.

[Footnote: 11](#) 11/ The terms of the "teach-out" program are as follows:

1. On or after the date this initial decision (or any revision thereof by the Secretary) becomes a final decision of ED, Katie may not enroll new students whose education will be paid, in whole or part, pursuant to the student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended. In the event this initial decision is not appealed to the Secretary, this date is 20 days after the initial decision is received by both parties. 34 C.F.R. § 668.90(c)(1).

2. Katie may not be placed on the reimbursement payment system by ED unless it violates the repayment agreement with ED pertaining to the \$33,853 of debt determined in the program review identified as PRCN: 88106010.

3. Katie's eligibility to participate in the student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, is terminated effective the earlier of--

(a) the date on which a student would complete the 900 clock hour program of Katie assuming he or she was enrolled as a full-time student on the day before the initial decision in this case (or any revision thereof by the Secretary) became a final decision of ED;

(b) nine months after the date upon which the initial decision in this case (or any revision thereof by the Secretary) became a final decision of ED; or

(c) 45 days after the date upon which the initial decision in this case (or any revision thereof by the Secretary) became a final decision of ED, where the fines imposed by this initial decision (or any revision thereof by the Secretary) are not paid within 30 days after the date upon which the initial decision in this case (or any revision thereof by the Secretary) became a final decision of ED.

Footnote: 12 12/ This value presumably reflects an appraisal. The curatrix incurred \$1,200 in appraiser fees and, based on a review of the assets in the possession of the curatrix, this asset and some personal effects listed at \$20,000 are the only assets which appear to require an appraisal to determine their value.

Footnote: 13 13/ A lesser penalty such as a fine is inappropriate in this case because it would simply aggravate Katie's financial condition--the primary basis for the imposition of the termination of Katie's eligibility. Moreover, in light of Katie's historical earnings, it appears unlikely that there will a significant change in its net worth in the future.

Footnote: 14 14/ ED requires the certification by the accountant or expert so that it avoids the necessity of reviewing the institution's documents and records.