IN THE MATTER OF UPSALA COLLEGE,
Respondent.

Docket No. 93-148-ST
Student Financial Assistance Proceeding

DECISION

By letter-notice (Notice) dated October 22, 1993, the Compliance and Enforcement Division (Enforcement) of the Office of Postsecondary Education of the U.S. Department of Education (ED) seeks to terminate the eligibility of Upsala College (Upsala) of East Orange, NJ, to participate in programs authorized under Title IV of the Higher Education Act of 1965, as amended (HEA). Enforcement also seeks to fine Upsala $40,000. (Initially, a fine of $80,000 was proposed.)

Upsala has conducted deficit operations during the past three years. As a result, its financial responsibility is questionable. It cannot continue to participate in HEA programs except as certain statutory provisions are satisfied. Upsala also is required to file compliance audits. Enforcement asserts that Upsala must make an annual filing and that one such audit was over a year late.

Oral hearing on the Notice was held on February 15, 1994, and February 25, 1994.

Post-hearing initial and reply briefs were filed.

Upsala College is a non-profit institution of higher education located in East Orange, NJ. Upsala serves many students who usually would not be considered ready for college and assists them in developing skills which will allow them to complete college. (Tr. 192) It offers programs in humanities, natural sciences, social science, fine arts, social work, and accounting. (Tr. 128) Upsala's student body is forty percent Afro-American and ten percent Hispanic (Tr. 129), and many of its students, minority and nonminority, come from at-risk backgrounds.

Enrollment at Upsala increased from 475 in the fall of 1990, 674 in the fall of 1991, 825 in the fall of 1992, to 1,003 in the fall of 1993. (Tr. 135) Upsala has designed an effective recruiting plan and projects an additional 125 to 150 students next year. (Tr. 146) Upsala's Chief Financial Officer's financial project-tons, based on actual enrollment for 1994 and projected enrollments for 1995, 1996, and 1997, are dependent upon increasing student enrollments. (Upsala Ex. F) Currently, Upsala is meeting its budget projections for 1994, but continues in a deficit situation. (Tr. 138)

While the financial statements of Upsala indicate that the school has significant debt, the statements also reflect that Upsala has some resources and that most of the debt is owed to or guaranteed by creditors who no doubt hope that Upsala does not close, precipitously or otherwise. About $4.2 million of Upsala's debt is guaranteed by the city of East Orange and by

Essex County. (Tr. 204) About $1.8 million of Upsala's debt is owed to the Mission Fund of the Evangelical Lutheran Church of America, the Evangelical Lutheran Church of America, and four of Upsala's Lutheran-affiliated sister institutions. (Tr. 144, 174) No evidence was offered by any of these entities. Upsala is on an ED cash reimbursement system, so that only one semester of Federal funds is at immediate risk. (Tr. 203, 211-12)

A certified public accountant (CPA) who performed an audit for Upsala testifies that he had no doubt as to the ability of Upsala to continue for at least the next fiscal year. (Tr. 233-34) Julio Izquierdo, Chief Financial Officer of Upsala, also testifies that there is no reason to believe that Upsala would close before the end of an academic term. (Tr. 209) ED did not present a CPA's opinion in rebuttal. Significantly, ED's key witness, Mr. Selepak, does not state that Upsala is "financially unstable" in the near term. (Tr. 96)

Section 498c(c)(3)(C) of the HEA (20 U.S.C. .1099c(c)(3)(C)) provides:

The Secretary shall determine an institution to be financially responsible, notwithstanding the institution's failure to meet the criteria under paragraph's (1) and (2), if--...such institution establishes to the satisfaction of the Secretary, with the support of a financial statement audited by an independent certified public accountant in accordance with generally accepted auditing standards, that the institution has sufficient resources to ensure against the precipitous closure of the institution, including the ability to meet all of its financial obligations (including refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred in programs administered by the Secretary).... (emphasis added)

This provision was added by 1993 amendment to the HEA. It provides that institutions which have adequate resources to prevent a precipitous closure are "financially responsible" and should not be terminated from participation in the student financial assistance programs of Title IV. This provision is one of the alternatives to the numeric financial responsibility standards of .498c(c)(1) and (2). Congress enacted these alternatives pursuant to the Higher Education Amendments in 1992; the 1992 version of .498c(c)(3)(C) required an institution to meet a "going concern" standard. The principle of this alternative was retained in 1993 when Congress changed the language to require only "sufficient resources to ensure against... precipitous disclosure." The 1993 amendment also eliminated any element of discretion of enforcement of this provision by ED by deleting the word "may" and inserting "shall," thus requiring ED to give effect to the ordinary meaning of the statute.

In Technical Career Institute,See footnote 1 [1] this Tribunal held that ED exceeded its authority in requiring an institution to meet the financial responsibility standards of more than one of the statutorily required alternatives. (Parenthetically, it should be noted that TCI not only met the going concern test, it also met the numeric financial responsibility standards.) As this Tribunal held, the statute clearly provides that the standards are alternatives, not cumulative requirements. Indeed, ED's currently proposed regulations, which are not yet effective, acknowledge the alternative provided by . 498 c (c) (3) (C) .See footnote 2 [2]

While courts give great deference to a federal agency's interpretation of the statutory framework under which they operate, the plain meaning of a statute is controlling in the absence

of a "clearly expressed legislative intention to the contrary".See footnote 3 [3] ED has not established that there is any basis in legislative history which would indicate that .498c (c) (3) (C) should be interpreted contrary to its express language. Certainly, if Congress intended no alternative to the numeric standards, it could have so amended the provision in 1993; instead Congress amended the provision to make it mandatory, not discretionary.

The congressionally mandated standard of "sufficient resources to ensure against... precipitous closure" may be more rigorous in some cases than ED's other standards for financial responsibility. However, this stern standard serves well the 1978 ED policy on promoting education by allowing educational institutions to stay open and provide quality education even though they may not meet the profitability standards of for-profit businesses. While federal education funds might be less at risk if all institutions were required to meet financial numeric standards, this interest does not outweigh society's interest in keeping otherwise strong and viable institutions open if they are not in danger of precipitous closure. When an institution educates many at-risk students, it may not have the endowment or revenues of an Ivy League institution. Nonetheless, it serves the students and the community. As Congress presumably determined when enacting .1099c(c)(3)(C), public policy is not necessarily served by closing down all educational institutions which are financially at risk.

Instead of admitting that .498c(c)(3)(C) provides an alternative means of meeting financial responsibility, Enforcement appears to contend that Upsala must meet the numeric standards set forth in .498c(c)(1)--(2) even though .498c(c)(3) clearly provides four alternatives. (Tr. 84-85)

The October 23, 1993 Notice of Enforcement to terminate Upsala refers to Upsala's failure to meet the Secretary's standards for financial responsibility under 34 C.F.R. .668.13 (c). (ED Ex. 1) This regulation has not been amended to reflect the 1993 statutory alternative of "sufficient resources to ensure against... precipitous closure." In fact, it was not amended to reflect even the 1992 "going concern" version of .498c(c)(3)(C). Whether the benchmark is "going concern" or "precipitous closure," the principle of alternatives to numeric standard remains the same. The Secretary's currently proposed rule .668.15 would replace .668.13 and does provide for this alternative, but this rule is not yet effective.See footnote 4 [4]

Inexplicably, Enforcement asserts that it has unfettered discretion to impose its own financial responsibility standards, notwithstanding the alternatives provided by Congress in .498c(c)(3). (Tr. 84-85)

ED does not have the authority to enforce regulations which are inconsistent with a statute enacted by Congress.See footnote 5 [5] While 34 C.F.R. .668.13 provides for certain regulatory standards for financial responsibility, these standards are superseded by the statutory standards set forth by .498c(c).

Furthermore, it would be an abuse of discretion for Enforcement to proclaim it is not "satisfied" with convincing evidence that there is no threat of precipitous closure. As the United States Supreme Court stated in Motor Vehicle Manufacturers Association of United States, Inc. v. State Farm Mutual Automobile Ins. Co., 463 U.S. 29, 42 (1983):

[T]he agency must examine the relevant data and articulate a satisfactory explanation for its action including a "rational connection between the facts found and the choice made."

Enforcement also imposes a letter of credit as a requirement for Upsala to meet financial responsibility standards. This would be erroneous if Upsala meets the standards of the alternative contained in .498c(c)(3)(C). ED's authority for imposition of the letter of credit is 34 C.F.R..668.13(d)(1) which provides:

The Secretary may determine an institution to be financially responsible, even if the institution is considered not to be financially responsible under paragraphs (b), or (c)(l) through (c)(3) of this section, if the institution submits to the Secretary a letter of credit payable to the Secretary in an amount established by the Secretary, or any other document requested by the Secretary that demonstrates that the institution has sufficient financial responsibility to begin or to continue to participate in any title IV, HEA program. (Emphasis added)

This regulation allows ED to determine an institution financially responsible only when the institution has been unable to otherwise qualify as financially responsible.See footnote 6 [6] Nothing in this language gives ED the authority to require a letter of credit from an institution which has met the financial responsibility standards or to impose standards inconsistent with "he statutory standards set by Congress.

Upsala believes that Enforcement bears the burden of persuasion on the issue of whether an irstitution "has sufficient resources to ensure against the precipitous closure of the institution." Upsala cites 34 C.F.R. .668.88(c)(2) which provides: "The designated department official has the burden of persuasion in any fine, suspension, limitation or termination proceeding under this subpart." Furthermore, in Technical Career Institute (TCI),See footnote 7 [7] this Tribunal held that the designated department official seeking termination bears the overall burden of persuasion. However, it must be recognized that the burden of going forward with evidence can shift from one party to another. The ebb and flow of evidence in a proceeding commands that parties cannot rest on their oars. In this matter, Enforcement shows that the financial position of Upsala is poor. Upsala, of course, says that its situation is improving.

While the 1993 financial statement indicates that Upsala has significant debt, it also reflects that most of the debt is owed to or guaranteed by creditors who may have a strong desire that Upsala not close. Unfortunately, these creditors, unlike those in TCI, did not testify. Upsala cites the decision of this Tribunal in TCI finding that the school therein was a "going concern" because it was in the creditors' best interests to keep the institution open. However, as noted, the primary creditors did testify therein. Also, TCI is profitable and, again as noted, meets ED numeric tests. Upsala does not meet the numeric tests.

When a statute does not otherwise define a word, it is a rule of statutory construction that the word is to be interpreted by its "ordinary, contemporary, common meaning."See footnote 8 [8] Webster's New World Dictionary (2nd Coll. ed. 1982) ("Webster's") defines "precipitous" as "steep, like a precipice". Webster's defines the adjective "precipitate" as "falling steeply, rushing headlong, flowing swiftly...acting, happening, or done very hastily or rashly...very sudden, unexpected, or abrupt." Based on the ordinary meaning of the words "precipitous closure," an

institution meets the financial responsibility standards if it has "sufficient resources" to "ensure" against a sudden, unexpected, or abrupt closure. Consequently, Upsala does not need to meet a standard of never closing, but must only meet a standard of having enough resources to avoid an abrupt or unexpected closure.

Upsala's evidence that it has sufficient resources to ensure against precipitous disclosure is somewhat supported by its 1993 financial statement, which was audited by an independent certified public accountant in accordance with generally accepted auditing standards as required by the statute. (ED Ex.5) (Tr. 232) The 1993 financial statement indicates that Upsala has $15,620,120 in assets, including $2,327,309 in cash equivalents in Trust and $1,887,018 in student receivables, not including those of doubtful collectibility. (ED Ex.5, p.2)

The 1993 financial statement is supported by the testimony of Donald Roepke, the certified public accountant with the firm of Virchow, Krause Helgeson & Company (Virchow, Krause) which performs the audits of Upsala. Mr. Roepke majored in accounting and has a MBA from the University of Wisconsin. He is a practicing accountant with 30 years of experience. (Tr. 226) For sixteen years, Mr. Roepke spent in excess of fifty percent of his time performing accounting services for institutions of higher education. (Tr. 228) Mr. Roepke also is a member of the Advisory Council to the Accounting Principals Committee of the National Association of College and University Business Officers (NACUBO), in which role he counsels NACUBO on the applicability of accounting principles to higher education. (Tr. 228)

Mr. Roepke testifies that, with respect to the 1993 financial statement, the absence of a qualification in the opinion letter indicating a possibility that Upsala was not a going concern indicates that his firm had no doubts as to the ability of Upsala to continue for at least the next fiscal year. (Tr. 233-34) Mr. Roepke testifies that although his firm felt it necessary in the 1991 opinion letter to refer to the possibility that Upsala might not be a going concern, the firm felt no need to make such a reference in 1992 and 1993. (Tr. 229-32) Mr. Roepke testifies that, on the basis of the 1993 audit, the accounting firm Virchow, Krause concludes that Upsala would not close mid-semester for at least the upcoming year. (Tr. 234)

Julio Izquierdo, Chief Financial Officer of Upsala, also testifies that he had no reason to believe that Upsala would close before the end of an academic term. (Tr. 209) Mr. Izquierdo has a Bachelor's degree in accounting and worked four and one-half years as an accountant for Peat, Marwick where he worked mostly on hospital and college accounts. (Tr. 198)

ED offers no C.P.A. testimony in rebuttal.

Dr. Karsten, President of Upsala, has experience working at three financially troubled institutions, two of which are now doing well. (Tr. 133) When he came to Upsala in 1988, college enrollment was going down, the faculty had decreased from 100 to about 50, and the college's buildings and grounds were badly in need of repair. (Tr. 134) Enrollment increased from 475 in the fall of 1990, to 674 in the fall of 1991, to 825 in the fall of 1992, and to 1,003 in the fall of 1993. (Tr. 135) Upsala has designed an expansive recruiting plan and projects an additional 125 to 150 students next year. (Tr. 146) Alumni giving increased from $125,000 in fiscal 1992 to $330,000 in fiscal year 1993. (Tr. 135) Although Upsala suffered a $3 million loss

in fiscal year 1992, it showed a $35,000 gain for fiscal year 1993. (Tr. 136) (Because Upsala is a nonprofit institution, the terms profit and loss are not entirely relevant.) Still Upsala has not met ED numeric standards for three years. Mr. Izquierdo's projections, based on actual enrollment for 1994 and projects enrollments for 1995, 1996, and 1997, are possible. (Upsala Ex. F) Currently, Upsala is meeting its budget and projections for 1994. (Tr. 138) These do not establish that Upsala will meet ED financial numeric tests nor do they establish that Upsala will not be deeper in debt. Mr. Roepke testifies why Virchow & Krause decided to remove its going concern note from its 1992 audit:

[W]e [Virchow Krause] were able to ascertain... that the College was coming out' of the low point at which their enrollment had deteriorated. They had a business plan for going forward that looked logical and reasonable to us. It was our viewpoint after evaluating all of the material that was available to us that it was probable that... the institution would be able to continue for the foreseeable future.

(Tr. 231)

Upsala's support from the East Orange community and affiliated religious institutions certainly is a resource against precipitous closure. It's long-term debt is owed to or guaranteed from friendly creditors who are interested in the well-being and continuation of the school.

Upsala certainly is an important contributor to the quality of life in the East Orange, Essex County, community, and consequently, the City of East Orange and Essex County, New Jersey, are supporters of Upsala. (Tr. 204) These two entities guarantee a $4.2 million capital improvement bond for Upsala for brick and mortar capital improvements. (Tr. 204) Because of their status as guarantors, these entities have an incentive to ensure that Upsala succeeds in its mission. If Upsala closes, they will lose $4.2 million in addition to community educational assets, jobs, and revenues.

About $1.8 million of Upsala's debt is owed to the Mission Fund of the Evangelical Lutheran Church of America, the Evangelical Lutheran Church of America, and four of Upsala's Lutheran affiliated sister institutions. (Tr. 144, 174) These affiliates, therefore, also have incentives to forgive minor defaults or provide additional assistance to Upsala.

However, no evidence is offered that these entities have any intention of adding to their obligations.

In my opinion, there is little risk that Upsala will close in mid-semester. Mr. Selepak testifies that he could recall only two instances of independent non-profit institutions closing in midsemester. (Tr. 116) Furthermore, Dr. Karsten, who has consulted with other colleges in financial distress, testifies that he knows of no instance in which an independent American private college or university closed mid-semester and that such an occurrence would be unusual. (Tr. 150)

Although Enforcement asserts at Tr. 85 that this Tribunal's standard of review of a decision to terminate by a designated department official is one of "arbitrary and capricious," I disagree.

ED's regulations indicate that this Tribunal (the hearing officer) conducts a de novo review as to what action is warranted. Ed regulations at 34 C.F.R. .668.909(a)(2) provide that the hearing officer must determine "whether the imposition of the fine, limitation, suspension or termination sought by the designated department official is warranted, in whole or in part." Indeed, 34 C.F.R. .668.88(c)(2) provides:

The designated department official has the burden of persuasion in any fine, suspension, limitation or termination proceeding under this subpart.See footnote 9 [9]

Furthermore, this Tribunal shall base its findings "only on evidence considered at the hearing and on matters given judicial notice." 34 C.F.R. .668.90(a)(4)

ED does not offer its own CPA's opinion in rebuttal, as was done in Technical Career Institute.See footnote 10 [10] Thus ED, unlike Upsala, did not offer a CPA who is qualified to give an expert opinion regarding the financial soundness of Upsala.

Even ED's own witness, Mr. Selepak, refused to say that Upsala was "financially unstable." (T. 96) Mr. Selepak does say that Upsala grants a higher percentage of scholarships than similar institutions but this was unsupported by hard evidence. (Tr. 110) Similarly, ED's credit report indicating that Upsala pays its bills slower than other institutions (Tr. 63) is insufficient to establish that Upsala does not eventually pay it bills.

The authority of the Tribunal herein is to terminate and fine, to fine but not terminate, to terminate but not fine, or to not terminate and not fine. Lengthy public interest arguments by Upsala that termination should not be imposed even if Upsala fails to meet financial responsibility standards are rejected.

DISCUSSION AND CONCLUSIONS

This termination action is based on Upsala's failure to meet the regulatory requirements for financial responsibility found in 34 CFR .668.13. Subsection (a) of that regulation provides, "To begin and to continue participation in any Title IV, HEA program, an institution must demonstrate to the Secretary of Education that the institution is financially responsible under the standards established in this section." The wording of this provision requires that it is the institution's responsibility to demonstrate that it is financially responsible. However, Enforcement accepts a separate responsibility in a termination proceeding such as this to carry the burden of persuasion. In the case of a financial responsibility termination action, Enforcement's responsibility is to demonstrate that the Respondent (Upsala) does not satisfy the requirements of 34 C.F.R. 668.13.

Enforcement points to the financial statements of Upsala for the years ending June 30, 1991, and June 30, 1992, plus the College's May 17, 1993, submission of a 5-year Business Plan, and a Statement of unrestricted Current Fund Revenues and Expenditures for the Year Ended June 30, 1992, and Quarter Ended March 31, 1993. Enforcement shows that the College's unrestricted current fund reflected material deficits over its three most recent fiscal years.

Indeed, after the termination and fine notice was issued, Upsala submitted a new financial statement for the 1993 fiscal year. That statement shows that Upsala continues to carry a material operating deficit in excess of $10 million dollars for at least three consecutive years.

Witnesses for Enforcement explain how the two most recent annual financial audits for Upsala fail regulatory requirements for demonstrating financial responsibility. Mr. Selepak, a financial analyst, testifies as follows:

Q. Can you show me the portion of the audit that you are relying on for that determination?

***

A. Okay. On that page [Ed Ex 5-5] as you go across it lists the unrestricted fund balance deficits for the year ending June 30th, 1992 which was $10,126,186.00, and for the fiscal year ending 1993 it was $10,091,223.00.

Q. You already know now that in your discussion that the unrestricted fund balance is negative. It is in excess of $10 Million for both in 1992 and 1993 years, is that correct?

A. Yes, sir.

Q. So, based upon your staff's analysis of this information, did you determine that the Institution failed to demonstrate financial responsibility under the regulations?

A. Yes. The determination of the school not meeting the factor of the financial responsibility was made and communicated to the school in March of 1993. That was based on reviewing the June 30, 1992 financial statement, as well as a comparison to the June, 1991 statement which reflected continuing unrestricted fund balance deficits.

The 1993 financial statement was presented to us after we had initiated -- or, after we had sent a letter to the school requesting that surety be posted.

Tr. 44. Mr. Selepak also explains that the unrestricted fund deficit shown in Upsala's 1993 financial statements increased by over $3 million from the deficit shown in the institution's 1991 statements. (Tr. 62)

This information is not contradicted, and no witness suggests that the reported amounts are inaccurate.

As permitted under section 498(c)(3)(A) of the HEA, Upsala has the option to submit a letter of credit to demonstrate that it is financially responsible. 20 U.S.C. . 1099c(c)(3)9(A). The amount established by Enforcement for the letter of credit is $1,115,000, a figure that is approximately seven percent of the total revenue Upsala receives annually. Upsala failed to obtain a letter of credit of any amount and appears unable to do so.

The burden on Upsala to post a surety of $1.15 million is relatively small, given the total annual revenues received by the institution. Unlike many proprietary schools, where HEA funds constitute a majority of the total revenues that are disbursed through the institutions, Upsala receives most of its revenues through other sources. Viewed in this context, a demand for surety approximating seven percent of Upsala's annual revenues is reasonable, especially given the testimony from Upsala's president that such a surety could be purchased by a financially sound institution for only $11,000. The discussion between this tribunal and Dr. Karsten, Upsala's President, highlight this point:

Q. How much does it cost to get a bond for $1.5 Million? A. About ... $11,000. ...

Q. It is not the cost of it, but simply the fact that you can't get one?

A. Precisely. We could get one in a heartbeat if we could find somebody. It is not that we haven't tried.

(Tr. 194-195) It is readily apparent that it is Upsala's financial condition that precludes it from posting the requested surety, and not the amount of the surety itself.

Mr. Selepak identifies a number of items that support the conclusion that Upsala is in a poor financial condition and that its continued operation is in doubt. These items include information that is evident in the institution's financial statements, as well as information reported from Dun & Bradstreet's national database that compares Upsala's financial strength and debt payment histories to comparable institutions.

The first concern that Mr. Selepak identifies is the disproportionately large amount of revenues that Upsala is shifting to pay scholarships and grants for its students. This practice, which in effect discounts the $17,500 of annual tuition and board chargesSee footnote 11 [11], is a way for the institution to increase student enrollment by bringing in students who could not, or would not, attend the institution at the full price charged. Mr. Selepak identifies the excessive amounts of scholarship funds and describes why the percentage of funds allocated to student scholarships is a potential indicator of financial risk:

Q. ... in your review of the audit for Upsala college for the year ended June 30, 1993, is there anything else in this audit that you have identified that reinforces your conclusion that it is appropriate to request surety from this Institution?

A. Yes, it is. On page ED 5-7 under "Expenditures and Mandatory Transfers" there is an item entitled "Scholarships and Grants." It is right above the total amount of $3.797 Million, which is 37 percent of total expenditures. This is an increase of 28 percent form the previous year of 1992.

(Tr. 47-48) Mr. Selepak goes on to explain why the amount of scholarship and grant money as a percentage of total revenue is important:

In the years that I have been looking at financial statements we have identified this particular item for a school that does not meet the standards of financial responsibility to be a much higher amount than other institutions that do meet the standards. In those schools that meet the standards it is usually six to seven percent.

***

Q. And this is almost four times that amount, is that correct?

A. For 1993, yes, it is.

Q. why is that important?

A. Well, non-profit institutions, by their general make-up, have established plants, and because they are more structured in their enrollment periods, by semesters rather than ongoing enrollments, with this established plant they are mandatory and there are scheduled and specified amounts of liabilities that the school must meet, and in times of enrollment decreasing a school will attempt to raise their enrollment by bringing in more and more students, and in some cases the students cannot afford, or the Title IV funding in their own makeup will not match the tuition and fees that an institution will be charging.

The Institution must account for this difference in the accounting terms and they do it by offering scholarships and grants to the schools. It is in one respect maybe a way of buying students.

(Tr. 48-50) During the hearing, it became readily apparent that student enrollments are the foundation upon which Upsala is attempting to stay ahead of its debts.

For example, Upsala has taken almost two million dollars of short-term loans from other colleges that, like Upsala, are affiliated with the Lutheran Church. Tr. 174-75. These loans require Upsala to meet enrollment projections and donor contribution levels.See footnote 12 [12] During his testimony, Upsala's President acknowledges that:

A. Well, probably the two most important revenue variables -- this is not probably. This is the case. The two most important revenue variables are tuition revenue and gift income. Tuition revenue depends upon controlling the internal scholarships, which are really tuition discounts, and upon the managed growth of the total number of students.

(Tr. 146) Upsala's President Karsten further explains that Upsala had been successful in increasing its student enrollment since he joined the institution in 1988. President Karsten states:

Well, I think a very good attention to the impact of financial aid is certainly an important point, but at that point right now we have established quite careful controls on the amount of aid that we give students, and the financial aid office is very responsive -- maybe this one thing is a variable.

(Tr. 159) Upsala's accountant, Mr. Roepke, also acknowledges that the increases in the amount of revenue allocated to scholarships for the 1993 financial statement are substantially higher than the scholarship revenues reflected on Upsala's 1992 financial statements. (Tr. 235 and Tr. 246)

For its 1992 audit, Upsala had a 24 percent or 25 percent ratio of unrestricted scholarships to tuition and fees. In the 1993 audit year Upsala's ratio rose to 38 percent. Mr. Roepke does not have data available to establish the range of ratios for similar schools, but he acknowledges that Upsala is shifting toward the higher end of the range. (Tr. 236) As well, testimony from Upsala's Chief Financial Officer shows that the institution is continuing to increase the money that it allocates to scholarships:

Q. Is it also correct, if we look at the expenditure for 6/30/93 for scholarships and grants, that is about -- well, it is reported at $3,763,941.00 A. Yes.

Q. it is also correct, isn't it, that the projected expenditure for fiscal '94 is a little more over half a million dollars larger than that amount. It is $4,305,056.00?

A. Correct.

(Tr. 223) Upsala's escalating re-investment in its students constitutes an indicator of an institution that is willing to discount overall tuition revenues by almost 40 percent in order to maintain numerical enrollment targets that are set in its short term notes.

The institution is borrowing extensively from its endowment funds. By doing so, Upsala is using the principal of assets that were donated and restricted in use by the donors to provide a long term revenue stream to the institution for specific purposes. Mr. Selepak discusses the disclosure of this borrowing that is set out in Upsala's 1993 financial audit:

Well, what is significant here is that it states that all endowment fund assets have been loaned to the current fund to support operations and that all unexpended plant funds, except assets held by trustee as collateral, have been loaned to investment in plant for various projects or to the current fund to support operations.

What this indicates to me is that the Institution is borrowing from the internal funds to sustain its operations.

(Tr. 53) Upsala's Chief Financial Officer, Mr. Isquierdo, provides some further information concerning this practice:

... We borrowed principal from one of the trusts and we -- as a covenant, one of the items that the trust does is pays for a chair in history, political science and library books and, as an item of the borrowing, we need to pay for that chair and those library books out of current fund monies.

(Tr. 219) Such borrowing is far enough removed from the ordinary course of business that Upsala sought approval from its Board of Directors and an opinion from its legal counsel that the action was legal. (Tr. 174)

Mr. Selepak explains that ED also uses the services of Dun & Bradstreet for evaluating information about the financial strength of an institution that ED's Financial Analysis Branch is reviewing. Dun & Bradstreet (D&B) is a nationally recognized credit reporting firm that compiles and maintains on a current basis financial information on numerous domestic businesses. (Tr. 62-63) D&B compiles information that establishes a normal payment history for a type of business, and then issues a report that shows how a particular business meets its payment obligations in comparison with similar companies.

Mr. Selepak explains the results and significance of his report on Upsala College that he obtained from D&B the day prior to the hearing:

Q. Okay, would you turn, again, sir, to what we have marked as Education Exhibit 12? ... Could you tell us what this is, please?

A. Again, this is a Dunn & Bradstreet report that I obtained on Upsala College. As you can see, it was printed yesterday, February 14th. Dunn & Bradstreet is a nationally recognized basis of storing data and making judgments as to the creditworthiness of business in the United States. Its data base contains in excess of 1.3 million files of various businesses, domestic businesses.

Q. Here. Well, let's just start with the first page of this document, Mr. Selepak, and can you please tell me the -- what you identify as the relevant information on here?

A. Other than going through the primaries .... it shows that the average payments are 33 days beyond terms and that the average industry payments are 12 days beyond terms.

The significance of this is, through Dunn & Bradstreet's computer data base they establish a record of -- well, first of all they segregate various types of businesses into various industries such as private non-profit institutions. It could be welding schools, car dealerships, what have you, industries that have the same type of mission, either profit or non-profit, and based on that they establish certain norms that are indicators in their procedures of an institution's financial stability.

***

What this shows is, under the commentary the average industry payments are 12 days beyond terms. Upsala College's payments are 33 days beyond terms, which is approximately two and one-half times longer it takes to pay its bills than the industry norm is.

(Tr. 62-64) This information shows that, even when compared to other comparable businesses, Upsala represents a larger credit risk because it is slower to pay its obligations when they are due.

Mr. Selepak also notes that D&B includes a risk evaluation as a standard part of its report, and that Upsala College carries the riskiest rating of "4" on a reporting scale of 1 to 4. (Tr. 65) This information is consistent with a downward spiral in the quarterly "Paydex" ratings that are

included on the D&B report, which Mr. Selepak explains decreased significantly from March 1993 to the hearing date in February 1994. (Tr. 66-67)

Dr. Karsten discloses that Upsala College works closely with the State of New Jersey, which is taking a heightened interest in monitoring the school to determine whether it continues to remain viable. Dr. Karsten explains that, as part of this procedure, the state requires Upsala to put in place a plan to provide for its students if the institution closes precipitously. (Tr. 149)

Consistent with Upsala's intent to maintain enrollments and donations, Dr. Karsten explains that Upsala has two categories of students that are non-traditional, and who would otherwise not be able to enroll into a college program due to their academic qualifications and financial need. (Tr. 166-169) Dr. Karsten first discusses the institution's recruitment of at risk student:

The most remarkable thing about our most at risk students who are in New Jersey -- they are called EOF students. EOF, Educational Opportunity Fund, in New Jersey is mandated by State law, and these students are by definition at high risk. They are, for the most part, full need. They bring no financial resources at all and they tend to be - their Board scores tend to put them into a class that would be inadmissible to most institutions, Board scores under 600 combined.

Q. So, what is your total EOF population right now?

A. I don't know how many EOF students we have. Maybe 140 total, something like that. 130, 120, 150, it is in that -- it is more than 100 and it is less than 150.

(Tr. 166) Dr. Karsten also describes another group of nontraditional students that are enrolled in Upsala's Challenge Program:

The Challenge Program are not admissible under regular admission standards because of their high school rank and grades and Board scores, but they are no -- also not admissible in the EOF Program, because they are not in that bad of shape by the numbers and by their own financial assets.

(Tr. 168) Dr. Karsten discloses that these non-traditional, high risk students now comprise 39 percent of Upsala's student population. (Tr. 169)

The most recent information from ED shows that Upsala College's cohort default rate has risen from 14.4 percent for Fiscal Year 1990, to 21.2 percent for Fiscal Year 1991. By crossing the 20 percent threshold, Upsala triggers a simple warning under 34 CFR 668.15 of a possible indication of impaired administrative capability. Both the President and the Chief Financial Officer are aware of the increase in Upsala's cohort default rate. (Tr. 175-76, 210) It is, incidentally, the institution's policy to encourage its students to take student loans:

Q. How much -- well, how much financial aid, proportionally, that Upsala College provides if federal? By federal, I mean Stafford Loans, as well as Pell Grants?

A. Loans as well as grants? Q. Yes, sir.

A. I don't know. I think perhaps Mr. Izquierdo knows that number, but it is very considerable. I can say this, that by policy our students virtually all -- in fact, I will say this. By policy, all students are required to take a loan. ...

(Tr. 160-61) 27

Upsala's accountant acknowledges that the institution fails to implement a prior audit recommendation to write off uncollectible student accounts that had already been reconciled on subsidiary accounts. (Tr. 271-272)

Increased enrollment at Upsala has not created an increase in the institution's number of graduates:

Q. When you took over your current position with Upsala College in November of 1988, you testified earlier that the student enrollment was 475 students?

A. No, it was probably about -- I don't recall where it was when I first went. It was perhaps in the high 600's. We had to get it turned around. We had to increase our admission standards, so it went down to 475 before it started back up again.

Q. Do you know what the size of the graduating class was in the spring of '91?

A. No, I don't. I could guess, but --

Q. What is your reasonable guess on that, sir? A. More than 100, less than 150.

Q. What was the size of the graduating class in the spring of '93?

A. It has been about the same since I have been there.

Q. Okay, so the graduating classes remain fairly constant from year to year?

A. Yes.

Q. At the same time you had an increase in student enrollments every year?

A. Yes. 28

(Tr. 153-54) As shown in Dr. Karsten's testimony, even though Upsala's enrollment has steadily grown throughout his tenure with the institution, there has not been a corresponding increase in the graduating class.

Even though it may be theoretically possible that the increase in enrollments is still working its way through the system, no such testimony is presented.

Upsala's Chief Financial Officer notes, most of Upsala's withdrawals are students that simply do not return after completing a semester. (Tr. 221)

Upsala places great emphasis on section 2(i)(9)(C) of P.L. 103-208 (107 STAT. 2479), the Higher Education Technical Amendments ("HETA") of 1993See footnote 13 [13]. ED is required to observe 20 U.S.C. . 1099c(c)(3)(C)See footnote 14 [14]. It is important to point out that only technical changes were made by HETA to the old section 498(c)(3)(C) of the HEA. Although final regulations incorporating the HEA Amendments of 1992 and the HETA of 1993 are not yet promulgated,See footnote 15 [15] the HETA changes are explained in part by Senator Pell.See footnote 16 [16]

Upsala seeks to avail itself of HETA's new provision. Upsala argues that the absence of a "going concern" finding in its most recent audit is a positive guarantee from its accountant that the institution has sufficient resources to ensure against its precipitous closure.

However, the accountant does not agree that he is able to make any such endorsement:

Q. Are you satisfied, based on the '93 audit, that the Institution has sufficient resources to insure against the precipitous closure of the Institution?

A. Well that perhaps calls for a judgment that we didn't really make as part of determining whether there was sufficient basis to not have substantial doubt about the ability.

I impliedly -- implicitly -- the evaluation process is such that if we do not -- if we do not mention the terminology "substantial doubt",; we therefore have no reason to believe that they are unlikely to continue for a period of time not to exceed the end of the next fiscal year.

The terminology insure, perhaps suggests, something that our opinion is not oriented towards -- that is to say that we are not guarantors.

(Tr. 232-33) During cross-examination, Mr. Roepke again confirmed the limitations on his role as the institution's auditor:

Q. Mr. Roepke, you testified earlier that you just do not view the role of a CPA as being a guarantor of the school's financial -- continued financial operations, is that correct?

A. That is correct. (Tr. 265)

A review of the evidence put forward in the hearing shows that Upsala is current in paying program liabilities and does not owe HEA refunds. It also does not have any "going concern" finding in its 1993 financial audit. It further appears that Upsala will not close during the ongoing semester. From this information, Upsala asserts that it is financially responsible pursuant to the new provision in the HETA. Enforcement, on the other hand, seeks to restrictively construe the new provision to the point of extinction.

Enforcement would permit an institution to avail itself of section 2(i)(9)(C) of HETA only in situations where Enforcement itself agrees. I reject this narrow interpretation. Nonetheless, Enforcement also argues that Upsala has an obligation, given it poor financial condition, to put in place mechanisms to ensure against its precipitous closure. 20 U.S.C. . 1099c(c)(3)(C).

Upsala does not submit a sufficient operational plan or contingency plan supported by its audited financial statement that demonstrates it it has sufficient resources to ensure against [its] precipitous closure, including the ability to meet all of its financial obligations." 20 U.S.C. . 1099c(c)(3)(C). In fact, Upsala's recently submitted financial statements viewed in combination with the other information introduced and discussed at the hearing compel a contrary conclusion. In this regard, the fact that Upsala is unlikely, because of its religious and local government ties, to close in mid-semester is not a sufficient showing. Upsala is on a downward financial spiral and is being held up only by increasingly placing Federal funds at risk. As well, the fact that Upsala is receiving Federal funds on a reimbursement basis serves only to reduce the immediate risk to Federal funds. Such does not reduce the high degree of Upsala's financial distress. In my opinion, the term "precipitous closure" cannot be confined to the ongoing semester. Each school must be examined on its own merits, and it is clear that Upsala survives only because it increasingly places Federal funds at risk.

The original notice to terminate and fine Upsala termination was based upon what was then considered to be two years of delinquent audits. However, after the notice was issued, ED received two A-133 reports, "Audits of Institutions of Higher Education and Other Nonprofit Organizations," for the one-year periods ending June 30, 1991, and June 30, 1992. These were received in July, 1993. The audit reports, which cover the College's administration of the Pell Grant, SERG, Perkins Loan, W-S, and FFEL programs for the 1991 award year and 1392 award year, were due by June 30, 1992, and June 30, 1993, respectively. The audit for the 1991 award year was a year late.

Enforcement, thus, modifies the Notice. The proposed fine is reduced from $80,000 for failure to file two audits to $40,000 for Upsala's failure to submit one of the audits. Enforcement also deletes the proposed termination of Upsala upon the basis of a failure to file an audit. Enforcement Director Lipton explains his modification of these actions:

Q. ... Can you explain why you have requested a fine of $40,000 for that failure to file the audit?

A. The Department in general seeks to fine all institutions that submit audit reports late. Failure to submit an audit report or submitting an audit report late is a serious offense.

It deprives the Department of Education of an opportunity to determine liabilities, to determine if the institution is in compliance with the student financial assistance program regulations, and therefore it is the policy of the student financial assistance programs, and of the Department of Education, to fine institutions that don't submit audits or submit audits late.

Q. Is it correct, Mr. Lipton, that you had also sought both a larger fine and the termination of the institution for this violation in this proceeding?

A. It was -- past tense. Yes. At one time we sought a larger fine, and $80,000 fine and we did include as one of the charges to terminate the institution for failure to submit audit reports.

Q. And those -- and those have now been reduced to only a $40,000 fine?

A. That is correct. And we are not seeking to terminate the institution for failure to submit audit reports any longer.

(Tr. 297-98)

Pursuant to 34 CFR .668.23, ED requires an institution participating in a Title IV, HEA program to conduct a financial and compliance audit of its financial and program transactions for that program. The audit must be performed at least once every two years and must cover the award years that have elapsed since the previous audit. The audit must be conducted by an independent auditor in accordance with audit standards and guidelines issued by the General Accounting Office and ED's Office of Inspector General.

However, an institution that chooses to submit its audit report in accordance with Office of Management and Budget Circular A-133, as permitted by 34 CFR .668.23(d)(2), is required to submit its audit report within 13 months of the end of the last award year covered by the audit. Therefore, when the institution uses an annual period for its budgeting and its financial operations, it is required to perform an A-133 compliance audit annually. Upsala's certified public accountant confirms this:

Q. Is your understanding now that in order to file an A-133 audit, Upsala must do so on an annual basis.

A. Yes, that is correct.

(Tr. 279) Although Mr. Roepke, testifies that his office received guidance by ED that Upsala's late audit submission would be accepted because of some uncertainty as to a phase-in period, he admits that no written advice of this was ever received. (Tr. 279)

In fact, even though Mr. Roepke testifies that a large part of the work he performs is for institutions that are comparable to UpsalaSee footnote 17 [17], none of Mr. Roepke's other clients assume that they can make biannual submissions of A-133 audits:

Q. To your knowledge, have any of the other colleges that you audit that filed in a similar manner had a proposed fine brought against them for that practice?

A. Almost every one of our clients at that particular period of time were already filing on an annual basis and so we didn't really face that issue. I believe, however, there were a few other institutions who were able to opt out of A-133 and submit their financial aids audit based on the Department of Education audit guides, and because of the regulations as to the program that they had in effect at the time, and it is my recollection that we had a couple of those who filed bi-

annually with the period ending in 1992. I am not 100 percent positive about that, but I believe it did.

(Tr. 240-41) It appears that Mr. Roepke's other clients understand that they either had to file an annual A-133 compliance audit, or "opt out of A-133" and file a biannual compliance audit.

Thus, even though the audit was subsequently submitted, it was over one year late.

This fine action is taken pursuant to section 487(c)(3)(B) of the Higher Education Act of 1965 (HEA), as amended by section 490 of Pub. L. 102-325, 106 Stat. 625-29 (1992), 20 U.S.C. .1094 (c)(2)(B), and 34 CFR .668.84, as amended at 57 Fed. Reg. 47,752-54 (1992). Title IV, HEA program regulations permit a fine of $25,000 for each such violation of any provision of Title IV of the HEA or any regulation or agreement implementing this title. In determining the amount of the fine the Department considers the gravity of the offense and the size of the institution. (34 CFR .668.92)

Based upon the violation and the relative size of Upsala, a fine of $25,000 is appropriate, except that Upsala has very limited ability to pay. In my opinion, the gravity of the violation must be considered in the context of Upsala's exceedingly poor financial condition. I would impose a fine of $5,000.

For the reasons set out above, Upsala College is terminated from the HEA programs because it is not financially responsible. It also is fined $5,000 for the delinquent submission of a compliance audit.

In the absence of a timely appeal or stay, this decision shall become effective as a decision of the Secretary.

Dated this 17th day of May, 1994.

Paul S. Cross
Administrative Law Judge
Office of Higher Education Appeals
U.S. Department of Education
400 Maryland Avenue, SW
Washington, DC 20202-3644

Footnote: 1 [1] *i Docket. No. 92-91-ST, U.S. Dep't of Educ., (October 8, 1993) at 22.*

Footnote: 2 [2] *2 See 59 Fed. Reg. 9539-44, 9567-58, (February 28, 1994) (Attached hereto as Exhibit A).*

Footnote: 3 [3] *3 North Dakota v. United States, 450 U.S. 300, 312 (1983); United States v. Locke, 471 U.S. 84, 96 (- 985) . See also Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc. 467 U.S. 837 (1984) .*

Footnote: 4 [4] *4 See 59 Fed. Reg. 9539 (February 28, 1994).*

Footnote: 5 [5] *5 Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984); North Dakota v. United States, 460 U.S. 300, 312 (1983); United States v. Locke, 471 U.S. 84, 96 (1985).*

Footnote: 6 [6] *6 See Technical Career Institute, supra, note 4, at 29.*

Footnote: 7 [7] *7 Id. at 24.*

Footnote: 8 [8] *8 Diamond v. Diehr, 450 U.S. 75, 182 (1981); (quoting Perrin v. United States, 444 U.S. 37, 42 (1979) .*

Footnote: 9 [9] *9 See also Technical Career Institute, supra note 4, at 24.*

Footnote: 10 [10] *10 Id. at 14.*

Footnote: 11 [11] *11 Upsala's annual tuition is currently $12,500, and the room and board charges are an additional $5,000 per year, for a total of $17,500. (Tr. 164-165)*

Footnote: 12 [12] *12 The notes to the 1993 financial statement provide*

"The College is subject to restrictive covenants, which include requirements to maintain enrollment of no less than 800 students and contributions of at least $; Million throughout the term of the note." (Tr. 176)

Footnote: 13 [13] *13 The Higher Education Technical Amendments of 1993 became effective as if such amendments we-e included in the Higher Education Amendments of 1992 (P.L. 102-325), pursuant to § 5 of P.L. 103-208 (107 STAT. 2488).*

Footnote: 14 [14] *14 Again it bears repeating that under § 2(i)(9)(C) of HETA, the Secretary shall determine an institution to be financially responsible, notwithstanding _he institution's failure to meet the criteria under paragraphs (1) and (2), if-*

(C) such institution establishes to the satisfaction of the Secretary, with the support of a financial statement audited by an independent certified public accountant in accordance with generally accepted auditing standards, that the institution has sufficient resources to ensure against the precipitous closure of the institution, including the ability to meet all of its financial obligations (including refunds of institutional charges and repayments to the Secretary for liabilities and debts incurred in programs administered by the Secretary). 20 U.S.C. § 1099c(c)(3)(C).

Footnote: 15 [15] *15 A notice of Proposed Rulemaking reflecting the changes made by the Higher Education Amendments of 1992 and the Higher Education Technical Amendments of*

1993 was recently issued. 59 Fed. Reg. 39, 9526-9590 (1994) (to be codified at 34 C.F.R. . 668.15) (proposed February 28, 1994). The proposed regulation embodies an interpretation of the statute that is a preliminary interpretation unless and until adopted by the Secretary as a final rule.

Footnote: 16 [16] *16 During Senate hearings on the Higher Education Technical Amendments, Senator Pell commented, "We also clarify the financial responsibility provisions enacted as part of the 1992 Higher Education Amendments. This will protect institutions that are not financially at risk, but it does so without weakening the current law. It has been difficult to strike the necessary balance in this area, but the provisions in the amendment will, we believe, make sure that financially at-risk institutions will be subject to careful scrutiny and even exclusion from participation in Federal student aid programs. Our goal in this regard has been a constant one: to insure that students have access to a quality education at schools that are strong and viable institutions of postsecondary education." 139 Cong. Rec. 162-2, S16593 (daily ed. November 19, 1993).*

Footnote: 17 [17] *17 "We audit 13 of those institutions but that group of 29, which is loosely affiliated, engages us to develop a set of ratios, ratios which are generally recognized in higher education as being those that are appropriate to use to evaluate what is happening in an institution." (Tr. 235)*