

IN THE MATTER OF CALVINADE BEAUTY ACADEMY,
Respondent.

Docket No. 93-151-SA
Student Financial Assistance Proceeding

Appearances: Leslie H. Wiesenfelder, Esq., Dow, Lohnes & Albertson, of Washington, D.C., for Calvinade Beauty Academy.

Denise Morelli, Esq., Office of the General Counsel, for the Office of Student Financial Assistance Programs, United States Department of Education.

Before: Judge Ernest C. Canellos.

DECISION

On September 17, 1993, the Office of Student Financial Assistance Programs (SFAP) of the United States Department of Education (ED) issued a **final audit determination** (FAD) [See footnote 1](#) finding that Calvinade Beauty Academy (Calvinade) failed to submit an appropriate financial and compliance audit covering four fiscal years ending June 30, 1987, and an appropriate close-out audit covering two fiscal years ending June 30, 1988, as required by Title IV of the Higher Education Act of 1965, as amended (Title IV). See 20 U.S.C. § 1070 et seq. By letter, dated November 5, 1993, Calvinade filed a timely appeal of the FAD. Due to the illness of the administrative law judge initially assigned to this case, this case was reassigned to me.

SFAP seeks recovery of **\$1,047,381**: \$511,056 in estimated losses to ED for subsidy and anticipated default expenses in the Federal Guaranteed Student Loan (GSL) program, and \$536,325 in the Federal Pell Grant program. The issue before me is whether ED is entitled to its recovery. For the reasons stated below, I find that SFAP is entitled to the recovery it seeks on the basis of Calvinade's failure to submit acceptable audits.

Pursuant to 34 C.F.R. § 668.23 (1992), institutions that disbursed Title IV program funds were required to have an independent auditor conduct a financial and compliance audit of its Title IV programs at least once every two years in accordance with standards and procedures set out in Title IV regulations. In addition, in accordance with the applicable regulations, the audit must comply with audit guidelines developed by ED's Office of the Inspector General (OIG).

The pertinent facts in this case are not in dispute. In response to an audit report filed by Calvinade covering four fiscal years ending June 30, 1987, SFAP issued a FAD, dated September 27, 1990, wherein the agency determined that the audit report was defective because Calvinade's independent auditor did not express an opinion on the school's financial statements due to deficiencies in the school's accounting and time-keeping records. The auditor's report cited numerous weaknesses in the institution's fiscal procedures and internal control measures

including Calvinade's failure to maintain accurate student ledger sheets, its failure to monitor the satisfactory progress of its students, and the institution's inadequate recording and tracking of student attendance.

In addition, the institution lost its Title IV eligibility designation on June 29, 1989, as a result of the loss of its accreditation. Consequently, the FAD also noted that Calvinade had not submitted its close-out audit covering the period July 1, 1987 through June 30, 1989, as required, by Title IV for all institutions which become ineligible to participate in Title IV programs. Subsequently, Calvinade re-submitted audit reports covering each year at issue. By letter, dated May 8, 1992, the OIG rejected those audit reports and returned the reports to the institution. On May 20, 1992, SFAP reinstated the FAD on the basis that the audits were deemed defective by the OIG. According to the record, no subsequent re-audit reports have been received by ED. On September 17, 1993, SFAP, once again, reissued the FAD. The September 1993 FAD served to amend [the] May 20, 1992" FAD concerning Calvinade's outstanding audit liabilities. According to the September 1993, FAD, Calvinade's failure to submit audits in compliance with Title IV regulations requires the institution to reimburse ED \$536,325 in Pell Grant funds disbursed by Calvinade during the period covered by the deficient audit reports, and \$511,056 in estimated actual losses for default claims, interest, and special allowances for GSL program loans disbursed by the school during the same period.

As the basis for recovery, SFAP relies upon 34 C.F.R. § 668.24 (1992). Section 668.24 provides that if the OIG determines that an audit report reveals questionable expenditures or a failure to comply with applicable audit procedures, the Secretary may determine, based on the audit finding, the amount of funds improperly spent. According to SFAP, it has done just that in setting out the audit liabilities noted in the FAD. Calvinade argues that SFAP's pay-it-all-back liability determination denies Calvinade its right to contest both the reasonableness of the OIG's rejection of its audits and the legality of SFAP's demand for recovery of all Title IV funds at issue. [See footnote 2](#) According to Calvinade, SFAP's authority to recover funds as a result of findings from a final audit determination is limited to measuring an institution's liability by the amount of Title IV funds overpaid, overawarded, or misused by the institution. I do not agree.

The gravamen of Calvinade's argument was carefully considered and rejected in several cases before this tribunal. [See footnote 3](#) It is axiomatic that in a Subpart H proceeding, SFAP may recover funds as a form of damages flowing from the institution's breach of its Program Participation Agreement (PPA). [See footnote 4](#) In that regard, the enforcement of the PPA is in the nature of an action to recover damages for breach of contract and, therefore, in a Subpart H proceeding, SFAP is not without authority to recover Title IV funds spent contrary to the terms of the PPA *as well as* funds calculated as harm caused to an identifiable Federal interest, including estimated or actual default claims, interest, and special allowance charges.

In SFAP's calculation of liability, SFAP determined that Calvinade should repay ED \$511,056 in estimated losses for subsidy and default expenses and interest and special allowance expenses in the GSL program, and \$536,325 covering all Pell Grant program fund disbursements made by the institution during the award years at issue. According to SFAP, Calvinade's liability for GSL program loan disbursements was calculated by applying an actual loss formula to the total amount of GSL funds disbursed by the institution during the award years at issue. [See footnote 5](#)

This loss formula was used in lieu of requiring Calvinade to repay to the appropriate lenders the total amount of GSL loans disbursed by the institution during the award years at issue. In several cases before this tribunal SFAP's use of its actual loss formula has been permitted in those cases, like here, where the institution failed to provide SFAP with the requisite data required to measure precisely the school's liability.

SFAP proposed its calculation of GSL liability because the institution failed to provide SFAP with appropriate financial and compliance audits, which would permit SFAP to determine whether Calvinade disbursed Title IV funds contrary to program requirements. Although Calvinade may have had a reasonable explanation for failing to provide SFAP with proper audits, it is well established that the nature of the enforcement of Title IV programs, through the use of audit and determinations, creates the need for institutions to cooperate with SFAP by providing the agency with proper and timely audits when that information is needed to determine whether any, if not all, Title IV funds disbursed to the institution were spent contrary to statutory and regulatory requirements.

More fundamentally, an institution's cooperation in providing SFAP with documentation of its expenditure of Title IV funds is consistent with its fiduciary duty to account for the disbursement of Title IV program funds. In this proceeding, the institution has the burden of proving that the questioned expenditures were proper. 34 C.F.R. § 668.116(d); see also In the Matter of Sinclair Community College, Dkt. No. 89-21-S, U.S. Dep't of Educ. (September 26, 1991).

Consequently, to sustain its burden of proof, Calvinade must show that the unaccounted for Title IV funds were disbursed in compliance with Title IV. Clearly, in this case that burden has not been met. Accordingly, I uphold SFAP's calculation of liability and find that Calvinade owes a liability to ED for \$1,047,381 for failure to submit an appropriate financial and compliance audit covering four fiscal years ending June 30, 1987, and an appropriate close-out audit covering two fiscal years ending June 30, 1988.

ORDER

On the basis of the foregoing findings of fact and conclusions of law, it is HEREBY ORDERED, that Calvinade Beauty Academy pay to the United States Department of Education the sum of \$1,047,381.

SO ORDERED:

Ernest C. Canellos
Chief Judge

Issued: March 21, 1995
Washington, D.C.

Footnote: 1 The September 17, 1993, FAD is a reissuance of a FAD that was sent to Calvinade prior to September 1993, but was unsigned and undated.

[Footnote: 2](#) Although Calvinade asserts that it has a right to challenge whether ED may reject its audits, the institution has not raised that challenge in this proceeding. Indeed, Calvinade acknowledges that it was unable to compel its auditor to re-submit audits in accordance with SFAP's requests.

[Footnote: 3](#) See, e.g., In the Matter of Pan American School, Inc., Dkt. No. 92-118-SP, U.S. Dep't of Educ. (October 18, 1994); In the Matter of International Career Institute, Dkt. No. 92-144-SP, U.S. Dep't of Educ. (July 7, 1994); In the Matter of Lehigh Technical School, Dkt. No. 94-193-SP, U.S. Dep't of Educ. (March 17, 1995).

*[Footnote: 4](#) Section 487(a)(3) of the Higher Education Act of 1965 (**HEA**), as amended, 20 U.S.C. § 1094(a)(3), requires all eligible institutions to enter into a Program Participation Agreement with the Department. The PPA conditions the eligibility of institutions to receive HEA, Title IV program funds upon compliance with the agreement and with program regulations. See 34 C.F.R. § 668.12(b)(1). Consequently, Calvinade's failure to submit acceptable audits violates program regulations as well as the PPA.*

[Footnote: 5](#) The actual loss formula measures the estimated loss to ED that has or will result from the ineligible loans certified by the institution. Under the formula, an institution's cohort default rate is multiplied by the total amount of loans disbursed during a given award year to yield an estimated expenditure of defaulted loans. This estimate is added to estimated loan subsidies and special allowance payments made by ED during the award year to yield the actual loss formula liability.