

IN THE MATTER OF COSMETOLOGY TRAINING CENTER,
Respondent.

Docket No. 93-86-ST
Student Financial Assistance Proceeding

DECISION

Appearances: Loren A. Magsam, Esq., of Magsam & Harwig, Osseo, Minnesota, for the Respondent.

Edmund J. Trepaz, Esq., of the Office of General Counsel, United States Department of Education, for the Office of Student Financial Assistance Programs.

This is an action initiated by the United States Department of Education (ED) to terminate the eligibility of the six member institutions affiliated with Cosmetology Training Center (CTC) 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 in the amount of \$2,500 against CTC-Rochester. [See footnote 1 1/](#) This action was proposed following a review of CTC's financial statement for fiscal year 1992 which indicated that CTC failed to satisfy the financial responsibility requirement. Termination and a fine was also proposed for the CTC-Rochester school on the ground that it failed to file a biennial audit for the award years 1991 and 1992.

Based on the findings of fact and conclusions of law, *infra*, CTC institutions in West St. Paul and Rochester are terminated from participation in Title IV programs, and CTC institutions in Richfield, Faribault, Mankato, and Columbia Heights are terminated from participation in the GSL programs. Further, absent the submission of a letter of credit in the amount of \$75,000, the eligibility of CTC and its member institutions to participate in Title IV programs is terminated. Further, no fine is warranted in this matter.

I. FINDINGS OF FACT

The pertinent findings of fact are set forth in the opinion. The detailed findings of fact are set forth in the appendix, *infra*.

II. OPINION

Between July 9, 1993, and August 3, 1993, ED informed the six CTC institutions and their corporate parent that it intended to terminate these institutions from participation in Title IV programs under 34 C.F.R. § 668.86(a) (1993) and to fine CTC- Rochester \$2,500, pursuant to 34 C.F.R. § 668.84. By letter dated August 4, 1993, and within the period specified by 34 C.F.R. §§ 668.84(b)(1)(iii) and 668.86(b)(1)(iii), CTC filed its request for a hearing on behalf of all CTC institutions. Accordingly, jurisdiction is proper before this tribunal.

A. Termination

The Secretary of Education is authorized under Section 487(c)(1)(F) of the Higher Education Act of 1965, Pub. L. No. 89- 329, 79 Stat. 1219, as amended by Section 490 of the Higher Education Amendments of 1992, Pub. L. No. 102-325, 106 Stat. 627 (to be codified at 20 U.S.C. § 1094(c)(1)(F)), to prescribe regulations for--

(F) 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, 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, ED promulgated 34 C.F.R. § 668.86(a) which provides that--

[t]he Secretary may terminate or limit the eligibility of an institution to participate in any or all Title IV, HEA programs if the institution violates any provision of Title IV of the HEA or any regulation or agreement implementing that Title.

In the instant case, ED seeks to terminate CTC-Rochester due to its failure to file a biennial audit for award years 1991 and 1992. In addition, ED seeks to terminate CTC-Rochester and its

sister institutions due to their poor financial condition.[See footnote 2 2/](#)

Under 34 C.F.R. § 668.23(c)(1), an institution, which participates in the various student financial assistance programs, "shall have performed a financial and compliance audit of its Title IV, HEA programs . . . conducted by an independent auditor in accordance with the general standards and the [General Accounting Office's] standards for financial and compliance audits." The audit shall be performed at least once every two years and submitted to ED by March 31 of the year following the last award year. 34 C.F.R. §§ 668.23(c)(3) and (4)(i).

CTC-Rochester's biennial audit for the award years 1991 and 1992 was due on March 31, 1993. CTC-Rochester submitted its biennial audit on the date of the hearing, November 9, 1993, some seven months after the due date.

CTC argues that it did not intentionally disregard the regulations concerning the submission of the biennial audit; rather, the late filing was due to an error by its accounting firm and the school's owner. In this regard, CTC-Rochester's biennial audit was due on an odd-numbered year, while the biennial audits for its sister schools were due on even-numbered years. The last biennial audits for its sister schools were timely filed. The school's owner and the accounting firm simply overlooked the preparation and submission of the biennial audit for CTC-Rochester.

A culpable state of mind is not a prerequisite to this regulatory violation. Even though CTC-Rochester submitted the biennial audit, it still, nonetheless, failed to comply with 34 C.F.R. § 668.23(c)(4)(i) which requires that the audit be filed in a timely fashion. Under this circumstance, 34 C.F.R. § 668.90(a)(3)(iv) mandates termination of the institution. Accordingly,

CTC-Rochester is terminated from participating in Title IV student financial assistance programs.

ED also seeks to terminate the remaining CTC institutions on the ground that they failed the requirements of financial responsibility. In general, an institution is 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)(2) if--

(2) [u]nder the 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.

Notwithstanding the current ratio test, the Secretary shall determine an institution to be financially responsible even though its current liabilities exceed its current assets if--

(A) such institution submits to the Secretary third-party financial guarantees . . . such as letters of credit payable to the Secretary, which third-party financial guarantees shall equal not less than one-half of the annual potential liabilities of such institutions to the Secretary for funds under this subchapter. . . .

20 U.S.C. § 1099c(c)(3)(A). See also 34 C.F.R. § 668.13(d)(1).

The parties do not dispute that CTC failed to satisfy the ratio of current assets to current liabilities. [See footnote 3 3/](#) However, the parties dispute whether a letter of credit is required, and, if so, the amount thereof.

ED requested a \$500,000 letter of credit under 20 U.S.C. § 1099c(c)(3)(A). This amount equals 100% of the aggregate amount of Pell funds and GSL funds disbursed within the most recent fiscal year. [See footnote 4 4/](#)

CTC asserts two arguments to avoid or reduce the \$500,000 letter of credit. Initially, CTC proposes that an escrow agreement be executed between the parties in lieu of a letter of credit.

Escrow agreements are purportedly employed by ED in situations where a school's violation of the financial responsibility standard is minimal. An institution must fail the current ratio

test by .2% or less. In addition, the financial condition of the institution must have improved over the immediately preceding three to five years and the institution must be in compliance with the program and regulatory requirements with the exception of the current ratio test. Under the escrow program, ED allows an institution three years in which to improve its financial condition to the standard required by the regulations. [See footnote 5 5/](#) In the event that the institution fails to meet the financial responsibility standards within the three year period, the institution is automatically terminated from participating in Title IV, HEA programs.

CTC argues that its financial condition is improving and warrants its participation in the escrow program. ED responds that CTC has not complied with all of the program and regulatory requirements, i.e. it filed the biennial audit for CTC-Rochester untimely. ED also emphasizes

that CTC's current ratio is not within .2% of compliance. Lastly, ED notes that it is not currently offering escrow arrangements due to the substantial number of schools presently participating in the program.

In the instant case, CTC's most recent financial statement indicates current assets of \$211,692 and current liabilities of \$371,663. Based on the marked disparity between these figures, CTC's financial condition does not warrant an escrow agreement.[See footnote 6 6/](#) Accordingly, CTC's request for an escrow agreement is rejected.

CTC asserts that the letter of credit demanded by ED in the

amount of \$500,000 is excessive. In this regard, CTC argues that ED placed the schools on the reimbursement system for the receipt of Federal funds and that this system provides adequate protection to ED against any loss of student aid funds.[See footnote 7 7/](#) In addition, CTC offers, voluntarily, to terminate its GSL programs in an effort to reduce the amount of funds at risk. Therefore, CTC argues that the letter of credit should be eliminated or, at least, reduced to reflect any potential, realistic liability to ED.

Under the reimbursement system, the institution must demonstrate that it is entitled to Federal funds by complying with program requirements for awarding and disbursing institutional funds to eligible students who are enrolled in and attending eligible programs. When the institution has demonstrated that it has expended these funds in accordance with Title IV requirements, ED will reimburse the institution for funds expended.

Under the reimbursement system, the funds are usually requested through a reimbursement agent who analyzes the information provided by the institution rather than verifying the information based on a firsthand review of the documentation. Therefore, while the reimbursement system provides additional assurances that actual liabilities to the Secretary may be reduced, it does not eliminate the potential that the liability may accrue as a result of inaccurate information provided by the institution. Thus, the reimbursement system does not eliminate the need to post a surety.

The remaining matter concerns the proper amount of the letter of credit. Under 20 U.S.C. § 1099c(c)(3)(A), the amount of the letter of credit shall equal not less than one-half of the annual potential liabilities to the Secretary.

Where, as here, there is a dispute regarding the amount of the letter of credit, the hearing officer "must find that the amount of the . . . letter of credit established by the Secretary was appropriate unless the institution can demonstrate that the amount was unreasonable." 34 C.F.R. § 668.89(a)(3)(ii).

ED argues that a surety of twice the statutory minimum amount -- \$500,000 in this case -- is warranted due to several factors. The financial condition of CTC deteriorated from 1991 to 1992 which is indicated by a decrease in net worth from

(\$74,739) to (\$151,214) and an increase in operating losses from \$39,175 to \$76,475. In addition, CTC's auditor issued a "going concern" statement in the audited financial statement.[See](#)

[footnote 8 8/](#) Finally, ED asserts that it cannot trust CTC to perform properly within the program because it filed its fiscal 1992 financial statement some seven months late.

In light of the present circumstances, a letter of credit in the amount of \$500,000 is unreasonable. Initially, there is no evidence in the record which establishes a correlation between the factors cited by ED and the imposition of a demand for a letter of credit which is twice the statutory minimum of 50% of the annual potential liabilities. More importantly, however, there have been significant changes in CTC's operations which justify a substantial reduction in the amount of the letter of credit.

In determining the amount of the letter of credit, ED utilized the June 30, 1992 fiscal year Pell figure as part of the basis to compute the amount of the letter of credit. As of the hearing, the Pell grant figure for fiscal year 1993 was available. The 1993 figure is \$148,444 which is substantially less than the 1992 figure of \$235,000. Inasmuch as the amount of the letter of credit under Section 1099c(c)(3)(A) is based upon "annual potential liabilities" and the Pell grant disbursement has substantially decreased since the initial request for the letter of credit, it is not reasonable to use the earlier Pell grant figure, i.e. the 1992 figure.

Similarly, ED's \$500,000 figure reflected \$268,000 of GSL funds disbursed during the fiscal year ended September 30, 1991. CTC ceased, however, disbursing GSL funds in that year and has not participated in that program for the last two fiscal years. Under this circumstance, it is inappropriate to include any amount reflecting GSL disbursements in determining the amount of the letter of credit which is based on the annual potential

liability concept. [See footnote 9 9/](#)

The record also contains no evidence that CTC failed to pay refunds to its students. In addition, ED placed CTC on the reimbursement plan which provides additional, but not absolute assurance that Pell funds are presently disbursed in a proper manner.

In view of the above, a reasonable amount for the letter of credit requested by ED is the statutory minimum of 50% of the potential annual liabilities. Inasmuch as CTC disbursed \$148,444 of Pell funds during fiscal year ended June 30, 1993, the appropriate figure for the letter of credit is \$75,000. Such a letter of credit should adequately protect the Government's interest in the event of bankruptcy or the cessation of business activities by CTC which is, after all, the purpose of the letter of credit.

Where, as here, an institution has challenged the amount of the letter of credit, it is appropriate to allow the institution an opportunity to deliver the letter of credit in the amount ultimately determined as reasonable. CTC shall have 45 days from the date the decision in this action becomes final in which to deliver to ED a letter of credit in the amount of \$75,000. In the event that CTC is unwilling or unable to submit a letter of credit in this amount, its eligibility to participate in all student financial assistance programs of Title IV is terminated.

B. Fine

Under Section 487(c)(3)(B)(i) of the Higher Education Act of

1965, Pub. L. No. 89-329, 79 Stat. 1219, as amended by Section 490 of the Higher Education Amendments of 1992, Pub. L. No. 102- 325, 106 Stat. 627 (to be codified as amended at 20 U.S.C. § 1094(c)(3)(B)(i), the Secretary "may impose a civil penalty upon such institution of [an amount] not to exceed \$25,000 for each violation or misrepresentation" of any provision of this subchapter or any regulation promulgated thereunder.

ED seeks to impose a fine against CTC-Rochester in the amount of \$2,500 for failure to file a biennial audit for award years 1991 and 1992. "When assessing an appropriate 'punishment' for the violation of program regulations, it is the total punishment that must be appropriate." In re Beth Rochel Seminary, Dkt. No. 92- 110-ST, U.S. Dep't of Education at 7 (1993). Here, CTC-Rochester was terminated for its failure to file the biennial audit when due. Termination is the severest sanction which exists. Inasmuch as CTC-Rochester has been terminated and has submitted the audit, an additional sanction of a fine is clearly unwarranted. Accordingly, no fine is imposed.

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 CTC-West St. Paul and CTC- Rochester to participate in the student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, is terminated; it is further

ORDERED, that the eligibility of CTC-Richfield, CTC Faribault, CTC-Mankato, and CTC-Columbia Heights to participate in the Guaranteed Student Loan Program under Title IV of the Higher Education Act of 1965, as amended, is terminated; it is further

ORDERED, that CTC-Richfield, CTC-Faribault, CTC-Mankato, and CTC-Columbia Heights submit to the United States Department of Education a letter of credit in the amount of \$75,000 within 45 days after the decision in this action becomes final; and in the event that such letter of credit is not submitted within this period, it is further

ORDERED, that the eligibility of the CTC-Richfield, CTC-Faribault, CTC-Mankato, and CTC-Columbia Heights to participate in the student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended, is terminated.

Allan C. Lewis

Administrative Law Judge

Issued: January 21, 1994
Washington, D.C.

APPENDIX -- FINDINGS OF FACT

1. Cosmetology Training Centers, Inc. (CTC) was incorporated under the name of Minneapolis Beauty College, Inc. on April 1, 1970 in Minnesota, and changed its name to Cosmetology Training Centers, Inc. on April 19, 1979.
2. CTC is engaged in the business of cosmetology education. CTC owns and operates six Minnesota institutions which are comprised of locations in Richfield, Faribault, Mankato, West St. Paul, Rochester, and Columbia Heights.
3. On December 4, 1991, the United States Department of Education and CTC-Richfield, through its President, executed a Program Participation Agreement which authorized the institution to participate in the Pell Grant program, the Guaranteed Student Loan program which includes the Stafford Loan program, the PLUS program, and the Supplemental Loans for Students (SLS) program, the Perkins Loan program, and the Supplemental Educational Opportunity Grant (SEOG) program. The Program Participation Agreement also required the institution to comply with the statutes and regulations governing the Title IV programs in which it participates.
4. On December 28, 1991, the United States Department of Education and CTC-Rochester, through its President, executed a Program Participation Agreement which authorized the institution to participate in the Pell Grant program, the Guaranteed Student Loan program which includes the Stafford Loan program, the PLUS program, and the Supplemental Loans for Students (SLS) program, the Perkins Loan program, and the Supplemental Educational Opportunity Grant (SEOG) program. The Program Participation Agreement also required the institution to comply with the statutes and regulations governing the Title IV programs in which it participates.
5. On December 28, 1991, the United States Department of Education and CTC-Mankato, through its President, executed a Program Participation Agreement which authorized the institution to participate in the Pell Grant program, the Guaranteed Student Loan program which includes the Stafford Loan program, the PLUS program, and the Supplemental Loans for Students (SLS) program, the Perkins Loan program, and the Supplemental Educational Opportunity Grant (SEOG) program. The Program Participation Agreement also required the institution to comply with the statutes and regulations governing the Title IV programs in which it participates.
6. On December 28, 1991, the United States Department of Education and CTC-Columbia Heights, through its President, executed a Program Participation Agreement which authorized the institution to participate in the Pell Grant program, the Guaranteed Student Loan program which includes the Stafford Loan program, the PLUS program, and the Supplemental Loans for Students (SLS) program, the Perkins Loan program, and the Supplemental Educational Opportunity Grant (SEOG) program. The Program Participation Agreement also required the

institution to comply with the statutes and regulations governing the Title IV programs in which it participates.

7. On December 28, 1991, the United States Department of Education and CTC-Faribault, through its President, executed a Program Participation Agreement which authorized the institution to participate in the Pell Grant program, the Guaranteed Student Loan program which includes the Stafford Loan program, the PLUS program, and the Supplemental Loans for Students (SLS) program, the Perkins Loan program, and the Supplemental Educational Opportunity Grant (SEOG) program. The Program Participation Agreement also required the institution to comply with the statutes and regulations governing the Title IV programs in which it participates.

8. On August 11, 1992, the United States Department of Education and CTC-West St. Paul, through its President, executed a Program Participation Agreement which authorized the institution to participate in the Pell Grant program, the Guaranteed Student Loan program which includes the Stafford Loan program, the PLUS program, and the Supplemental Loans for Students (SLS) program, and the Supplemental Educational Opportunity Grant (SEOG) program. The Program Participation Agreement also required the institution to comply with the statutes and regulations governing the Title IV programs in which it participates.

9. The financial statements, prepared by the Certified Public Accounting Firm of Daniel G. Falk & Associates, P.C., for fiscal year ending March 31, 1992 list current assets of \$211,692 and current liabilities of 371,663 and, for fiscal year ending March 31, 1991, current assets were listed as \$263,025 and current liabilities as \$238,931. The ratio of current assets to current liabilities for 1992 was 1:1.76 and the current ratio for 1991 was 1.1:1. These figures were derived from the Balance Sheet of Cosmetology Training Center, Inc. as of March 31, 1992 and 1991--

1992 1991

ASSETS

CURRENT ASSETS

Cash	\$ 0	\$ 1,976
Accounts Receivable - Students	162,585	194,189
Due from American Image	0	1,287
Due from GSL Recipients	0	16,943
Inventories	49,107	48,630
TOTAL CURRENT ASSETS	211,692	263,025

FIXED ASSETS

Office Furniture and Equipment	516,354	517,103
Automobile	0	25,078
Leasehold Improvements	169,285	169,285
Building	54,000	54,000
Land	6,000	6,000
Total Fixed Assets	745,639	771,466

Less Accumulated Depreciation 613,875 598,520
NET FIXED ASSETS 131,764 172,946

OTHER ASSETS

Deposits 6,000 2,500
Stockholder's Loan 141,401 6,280
Goodwill - Net of Amortization 30,272 31,164
Covenant not to Compete 0 22,500
177,673 62,444

TOTAL ASSETS 521,129 498,415
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LIABILITIES AND STOCKHOLDERS' EQUITY

1992 1991

CURRENT LIABILITIES

Notes Payable \$ 21,478 \$ 21,761 Obligations Under Capital Lease 26,669 15,897
Net Bank Overdraft 896 0
Accounts Payable 60,855 13,939
Payroll W/H Taxes Payable 81,685 16,624
Income Tax Payable 726 0
Sales Tax Payable 1,873 2,909
Accrued Expenses 32,770 20,964
Deferred Lease Benefit 450 450
Unearned Tuition Income 115,920 86,120
Tuition Refunds Payable 9,019 26,471
Other Liabilities 19,322 33,796
TOTAL CURRENT LIABILITIES 371,663 238,931

LONG TERM LIABILITIES

Notes Payable - Long Term 114,729 130,327
Obligations Under Capital Lease 28,828 46,323
Deferred Lease Benefit 2,963 3,413
TOTAL LONG TERM LIABILITIES 146,520 180,063

TOTAL LIABILITIES 518,183 418,994

Stockholder's Equity

Common Stock 10,000 10,000
Additional Paid in Capital 144,160 144,160
Retained (Deficit) (151,214) (74,739)
TOTAL STOCKHOLDER'S EQUITY 2,946 79,421

TOTAL LIABILITIES AND EQUITY \$ 521,129 \$ 498,415
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10. For fiscal year ending March 31, 1992, CTC's current assets of 211,692 failed to exceed its current liabilities of 371,663. Therefore, the ratio of current assets to current liabilities was 1:1.76.

11. The financial statements for fiscal years ending March 31, 1992 and 1991, were prepared by the Certified Public Accountant on September 25, 1992 and submitted to ED on February 17, 1993. The date on which the financial statements were due was July 31, 1992. The record is clear that ED had provided CTC with an extension of time to submit the financial statements; however, the length of these extensions is not clear.

12. On September 25, 1992, Daniel G. Falk & Associates, P.C.,

Certified Public Accountants, prepared their independent auditor's report on CTC as of March 31, 1992 and 1991, and determined that the financial statements present fairly the financial condition of CTC. In addition, the report questioned whether CTC will continue as a "going concern" due to its failure to meet two financial responsibility tests promulgated by ED. Due to this failure, it is the opinion of the auditors that since CTC may lose Title IV funding, there exists substantial doubt as to whether it will continue as a "going concern."

13. A "going concern" refers to an existing solvent business. If an institution is no longer able to function as a "going concern," the assets listed in the financial statements would be restated at a liquidation value which has the effect, in most cases, of decreasing their value. This is the result of a forced sale of assets due to liquidation as opposed to the current fair market value currently listed on the financial statements that assumes that arm's length transaction in which, in the normal course of business, a transaction is negotiated by unrelated parties, each acting in his own self-interest.

14. Based on the statements issued by the independent auditor, it is his opinion that if ED terminates Title IV funding to CTC, it is likely that CTC's business operations will be discontinued.

15. CTC's financial statements for fiscal year 1992 were due to be submitted to ED on July 31, 1992. However, these statements were received by the Section 1 of the Financial Analysis Branch of the U.S. Department of Education on February 17, 1993.

16. CTC disbursed Federal funds for award year 1991 in the following manner--

GSL

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Pell Stafford PLUS SLS TOTAL

Rochester \$47,104 \$35,206 \$8,700 \$ 9,245 \$100,255

Columbia Heights 32,959 46,845 2,000 30,893 112,697

West St. Paul 38,029 22,977 3,000 19,500 83,506

Faribault 27,479 35,404 2,600 14,000 79,483
Mankato 37,780 31,661 7,870 2,000 79,311
Richfield 0 0 0 0 0
183,351 172,093 24,170 75,638 455,252

17. CTC disbursed Federal funds for award year 1992 in the following manner--
GSL

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Pell Stafford PLUS SLS TOTAL
Rochester \$49,421 0 0 0 \$49,421
Columbia Heights 28,720 0 0 0 28,720
West St. Paul 40,786 0 0 0 40,786
Faribault 34,007 0 0 0 34,007
Mankato 50,925 0 0 0 50,925
Richfield 27,174 0 0 0 27,174
231,033 0 0 0 231,033

18. CTC disbursed Federal funds for award year 1993 in the following manner--
GSL

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Pell Stafford PLUS SLS TOTAL
Rochester \$22,414 0 0 0 \$22,414
Columbia Heights 11,411 0 0 0 11,411
West St. Paul 30,936 0 0 0 30,936
Faribault 25,550 0 0 0 25,550
Mankato 40,883 0 0 0 40,883
Richfield 17,250 0 0 0 17,250
148,444 0 0 0 148,444

19. CTC has not participated in the GSL program since 1991.

20. Title IV figures are compiled and reported at various time periods depending on the program. The fiscal year under a Pell Grant program is July 1 through June 30 of the succeeding year. At the conclusion of the fiscal year, ED correlates the information and makes the information available 60 to 90 days thereafter. The fiscal year under the GSL program is October 1 through September 30 of the succeeding year.

21. ED requested CTC to post a letter of credit in the amount of \$500,000. This amount was determined utilizing Pell and GSL funding for the preceding two years, 1992 and 1991, respectively. The figures utilized by ED at the time it calculated the amount of the letter of credit were the most recent figures available. CTC was unable or unwilling to post a letter of credit in that amount.

22. In determining the amount of the letter of credit, the policy of ED is determine funding levels per Title IV program based on the latest information available. However, if an institution was eligible to participate in a particular program, but did not

participate in that program for the most recent fiscal year, ED determines the funding level based on the last year in which the institution participated in that program.

23. ED determined that the letter of credit should represent 100% of funds disbursed by CTC due to the deterioration in the financial condition of CTC from 1991 to 1992; that the institution had a 100% increase in operating losses from 1991 to 1992; that the independent auditor issued an opinion which raised substantial doubt as to whether CTC could continue as a "going concern;" and that CTC failed to provide its financial statements until seven to eight months after they were required to be submitted. Supervisors concurred with the amount of the letter of credit after reviewing the financial statements, the analysis conducted on the financial statements, a reading of Dunn & Bradstreet reports, and the recommendation of the junior official who established the amount of the letter of credit.

24. Once a letter of credit is established, it is reviewed annually upon receipt from the institution of its financial statement for the following year.

25. An escrow agreement is an alternative to posting a letter of credit. Escrow agreements are agreements executed by the Secretary and an institution which allows the institution to continue to participate in Title IV, student financial assistance programs. Under this agreement, an institution has three years to improve its financial condition such that its ratio of current assets to current liabilities exceeds 1:1. In the event that the institution fails to meet the current ratio standard within the three year period, the institution is automatically terminated from participating in Title IV, HEA programs.

26. Escrow agreements are utilized in situations where a violation of the regulatory standard of financial responsibility is minimal and that the institution has complied with the program and regulatory requirements with the exception of the current ratio test. Under the escrow agreement, the institution is required to retain an agent, usually a certified public accountant, which verifies that an institution has earned the Federal funds requested. Upon such proof, the Federal funds are disbursed to the agent for distribution to the institution.

27. CTC receives Federal funds under the reimbursement system of payment and has employed a certified public accountant, Gemcorp of Chicago, to act as its servicing agent. As a result of the reimbursement program, no refunds are due to students who withdraw from the institution since funds are received only after the student has completed the prescribed training.

28. In order to receive Federal funds under the reimbursement system of payment, the institution must first demonstrate that it

is entitled to Federal funds by complying with program requirements for awarding and disbursing institutional funds to eligible students who are enrolled in and are attending eligible programs. When the institution has demonstrated that it has expended these funds in accordance with Title IV requirements, ED will reimburse the institution (or credit the institution's account from its latest existing cash-on-hand balance), subject to any right of offset available.

ED performs a review of the documentation submitted to determine the accuracy and reliability of the information submitted in which it must balance the need to expedite reimbursement to the institution against its interest in ensuring that only proper disbursements are made to students. If ED deems it necessary, ED will require additional documentation of proper expenditures before ED makes a reimbursement payment to the institution. If an institution employs a certified public accountant, or a student financial aid consultant with demonstrated ability and experience in the administration of Title IV programs, to certify, after reviewing the institution's records and documents, that those records and documents support the institution's request for reimbursement, ED can expedite its review and shorten the time between the institution's claim submissions and ED's payment of those claims. Under the reimbursement payment system, an independent compliance audit is not performed for each claim submitted; the reimbursement agent reviews and analyzes the information provided by the institution.

29. CTC-Rochester was required to submit their non-federal biennial audit for award years 1991 and 1992 to ED's Regional Inspector General for Audit in Kansas City, Missouri on or before March 31, 1993. The biennial audit for award years 1991 and 1992 was submitted to ED on November 9, 1993.

30. In the biennial audit for CTC-Rochester, filed with the tribunal on November 9, 1993, the Certified Public Accounting firm of Thorsen, Coen & Company, Ltd., through its "Independent Auditor's Opinion on Compliance with the Common and Specific Requirements Applicable to Student Financial Assistance Programs," determined that CTC-Rochester complied, in all material respects for the years ended June 30, 1992 and 1991, with generally accepted auditing standards issued by the Comptroller General of the United States, the March 1990 Audit Guide of Student Financial Assistance Programs, and the Office of Inspector General's Non-Federal Technical Bulletin.

31. The biennial audit for CTC-Rochester has been introduced as evidence in this proceeding on November 9, 1993; however, as of the date of the hearing, the biennial audit has not been sent to the regional office in Kansas City.

32. CTC-West St. Paul had closed and ceased operations on August 28, 1993.

33. On July 9, 1993, ED notified CTC that it intended to terminate the eligibility of its institutions located in Richfield, Faribault, Mankato, West St. Paul, Rochester, and Columbia Heights, Minnesota to participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended. ED also informed CTC that it intended to fine CTC-Rochester \$2,500 for failure to file a biennial audit for award years 1991 and 1992.

34. On July 15, 1993, ED notified CTC-Rochester that it intended to terminate its eligibility to participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended. ED also informed CTC- Rochester that it intended to

impose a fine in the amount of \$2,500 for failure to file a biennial audit for award years 1991 and 1992.

35. On July 15, 1993, ED notified CTC-Mankato that it intended to terminate its eligibility to participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended.

36. On July 15, 1993, ED notified CTC-West St. Paul that it intended to terminate its eligibility to participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended.

37. On July 15, 1993, ED notified CTC-Columbia Heights that it intended to terminate its eligibility to participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended.

38. On July 15, 1993, ED notified CTC-Faribault that it intended to terminate its eligibility to participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended.

39. On August 3, 1993, ED notified CTC-Richfield that it intended to terminate its eligibility to participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended.

40. By letter dated August 4, 1993, Cosmetology Training Centers, Inc. filed a request for a hearing on behalf of all CTC institutions.

Footnote: 1 1/ More specifically, ED seeks to terminate CTC from participating in the Pell Grant, Supplemental Educational Opportunity Grant (SEOG), Perkins Loan, College Work-Study programs, and the Federal Family Education Loan (FFEL) program which includes the Stafford Loan, PLUS, Supplemental Loans for Students (SLS), and Consolidated Loan programs.

Footnote: 2 2/ Initially, the parties agree that the CTC school in West St. Paul has ceased operations and closed. As a result, the parties stipulated that this institution shall be terminated from participation in Title IV student financial assistance programs. Accordingly, CTC-West St. Paul is terminated.

Footnote: 3 3/ Specifically, as of March 31, 1992, current assets totaled \$211,692 and current liabilities totaled \$371,663, yielding a current ratio of 1:1.76.

Footnote: 4 4/ In this case, the most recent figures available as of the date of the initial request were \$234,763 of Pell funds in fiscal 1992 and \$268,171 in GSL funds disbursed in fiscal 1991 as follows:

*Location 1991 GSL 1992 Pell
Columbia Heights \$79,738 \$28,720*

West St. Paul \$45,477 \$40,786
Rochester \$49,421 \$53,151
Faribault \$53,004 \$34,007
Mankato \$41,531 \$50,925
Richfield \$ 0 \$27,174
Total \$268,171 \$234,763

[Footnote: 5](#) 5/ The agreement entered into between an institution and ED requires the institution to retain an agent, usually a certified public accountant, which verifies that an institution has earned the Federal funds requested. Upon such proof, the Federal funds are disbursed to the agent for distribution to the institution.

[Footnote: 6](#) 6/ While the Chief of Section 1 of the Financial Analysis Branch testified that escrow agreements are only made available to institutions whose current assets are within .2% of current liabilities, the existence of such a narrow standard is questionable in light of practical mathematical considerations. For example, under this purported standard, CTC's level of current assets must be \$370,913 or \$750 less than the current liabilities of \$371,663 in order to qualify for an escrow arrangement. In addition, ED argues that even if CTC's assets were within .2% of current liabilities, an escrow agreement would not be offered since ED is currently overburdened in administering escrow arrangements. While the absence of administrative capacity is not a sufficient legal basis to deny an escrow arrangement, the disparity between current assets and current liabilities is too significant to warrant an escrow agreement.

[Footnote: 7](#) 7/ 34 C.F.R. § 690.74 authorizes the Secretary to disburse funds to institutions by either the advance payment system or the reimbursement system. Under the advance payment system, the Secretary disburses funds to the institution in advance of its awarding of Pell Grants on the basis of a request by the institution for funds.

[Footnote: 8](#) 8/ "Going concern" is a "term which refers to an existing solvent business, which is being conducted in the usual and ordinary way for which it was organized." Black's Law Dictionary 622 (5th ed. 1979). In the present case, the certified public accountant issued an opinion on the financial statements of CTC reflecting concerns of CTC's continued viability--

[t]he uncertain conditions that the Corporation faces regarding the ability to provide student loans and grants to its students . . . creates an uncertainty about the Corporation's ability to continue in existence.

[Footnote: 9](#) 9/ Where an institution is not participating in the GSL program but remains eligible to participate, ED argues that the most recent GSL figure must be incorporated into the determination of the amount of the letter of credit regardless of the period of non-participation. ED's concern is that the institution may reinstate its participation in the program. ED reviews annually, however, the amount of the letter of credit and, therefore, has an opportunity to revise the amount of the letter of credit in the event there is a significant change in the circumstances which would include the reinstatement of the institution's participation in the GSL program.

Thus, ED's concern has little merit. Moreover, CTC has no intention of participating in the GSL program and no objection to terminating its eligibility to participate in the program if that action may affect the present proceeding. As a result, this decision terminates CTC's eligibility to participate in the GSL program and, therefore, there is no need, under any imaginable circumstance, to consider GSL funds distributed two years previously in determining the proper amount of the letter of credit.