

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

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In the Matter of

**CLASSIC BEAUTY COLLEGES,**

Respondents.

**Docket No. 96-147-SP**

PRCN: 199410900011

**Docket No. 97-33-SP**

PRCN: 199410900010

**Docket No. 97-58-SP**

PRCN: 199410900013

**Docket No. 97-59-SP**

PRCN: 199410900012

Consolidated Student Financial  
Assistance Proceedings.

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Appearances:

Mr. Jack King, Owner, Classic Beauty Colleges, Phoenix, Arizona, for Respondent.

Paul G. Freeborne, Esq., Office of the General Counsel, United States Department of Education, Washington, D.C., for Student Financial Assistance Programs.

Before:

Frank K. Krueger, Jr., Administrative Judge

**DECISION**

From November 29, 1993, through December 3, 1993, the Student Financial Assistance Programs (SFAP), U.S. Department of Education (ED), conducted unannounced program reviews at the following schools: Classic Beauty College, 42 N. Stapley Drive, Mesa, Arizona, 85205 (known as the East Mesa school) (Docket No. 96-147-SP); Classic Beauty College, 3227 E. Bell Road, Phoenix, Arizona, 85032 (known as the Paradise Valley school) (Docket No. 97-33-SP); Classic Beauty College, 4843 E. Main Street, Mesa, Arizona, 85206 (known as the Mesa school) (Docket No. 97-58-SP); and the Classic Beauty College, 1548-A W. Montebello, Phoenix, Arizona, 85015 (known as the West Montebello school) (Docket No. 97-59-SP). The schools are owned and operated as sole proprietorships by Mr. Jack King at a central location. The program reviews covered the 1992/93 and 1993/94 award years. After reviewing samples of student files and finding a large proportion of violations of program regulations, SFAP required the schools to conduct full-file reviews concerning students receiving Federal financial assistance during the years in question. Mr. King immediately objected to the time allowed by SFAP to conduct the reviews. Following inexplicable tarry by SFAP, it issued final program review determinations assessing Respondent schools a liability for all Federal student assistance disbursed by the Respondents during the two program years at issue. Respondents then requested hearings and all four

cases were consolidated pursuant to a joint request by the parties.

For the reasons provided below, I find in favor of SFAP.

## I.

After simultaneous compliance reviews, SFAP issued program review reports for all four schools on August 31, 1994. At each school, SFAP reviewed two samples of files. The first sample was subject to a comprehensive review of all Title IV requirements except refunds, and included twenty files. The second sample was reviewed concerning refunds only, and contained the files in the first sample plus an additional five to ten files. In the comprehensive sample, SFAP found fourteen violations at the East Mesa school and eighteen violations at each of the other three schools; many of the files at all of the schools contained multiple violations. In addition, SFAP found the following numbers of refund violations: twelve at the East Mesa school, six at the Paradise Valley school, five at the Mesa school, and nine at the West Montebello school.

The violations at all four schools were not only numerous, but varied. For example, at the West Montebello school SFAP found incorrect or missing refund calculations; unpaid refunds; Pell Grants distributed prior to enrollment and prior to midpoints; missing and invalid student aid reports; unauthorized powers of attorney; an undocumented and unenforced student academic policy; missing, incomplete, and discrepant attendance records; missing ability-to-benefit tests and failure to follow the publisher's procedures in administering the tests; inaccurate student account ledgers; failure to delay disbursement of Federal assistance to new students for thirty days; and late or inaccurate notice to lenders of withdrawn students. The violations at the other three schools were equally varied. In addition to the specific file violations, SFAP found a number of other systemic problems with the schools. Again using the West Montebello school as an example, SFAP determined that the school lacked administrative capability and financial responsibility; that the school had excessive default rates and was not fully implementing its default management plan; that exit counseling interviews with its students receiving Federal loans were not documented; that commissions for student referrals were being paid to its admissions personnel and to students in violation of Federal regulations; that bank accounts for Federal funds were not properly identified; that authorized program levels for Federal funds were being exceeded; and that accounting and audit records were inaccurate and not being adequately maintained. Again, the systemic violations at the other schools were equally numerous and varied. Based on these violations, SFAP required that the schools do a file review for all of its students who received Title IV aid during the years at issue. The program review reports outlined the areas that the schools should review in the files.

When SFAP issued its program review reports on August 31, 1994, it required the schools to complete the reviews within forty-five days, or by October 17, 1994. Respondents objected, claiming that, given the scope of the reviews, it was almost impossible to do them within the time allowed, and requested that they be given a minimum of six months, with the possibility of an additional four months if they were making satisfactory progress in completing the reviews. SFAP instead granted Respondents three months to do the reviews, with a due date of December 17, 1994. The due date was subsequently moved to January 3, 1995. Respondent did respond to the program reports, but not to the satisfaction of SFAP. In April of 1995, SFAP found the response inadequate, since the necessary file reviews were not completed, and provided the Respondents with an additional fifteen days to complete the reviews. On May 15, 1995, the East Mesa school stopped operations. On July 21, 1995, the West Montebello school voluntarily withdrew from the Title IV programs. On July 31, 1995, the program participation agreements for the Mesa and Paradise Valley schools expired. In July 1995, ED's Office of the Inspector General (OIG) served the Respondents with subpoenas and seized all of Respondents' fiscal files and a large number of Respondents' student files. In September and October 1995, SFAP reminded Respondents of their obligations to submit, within 45 days after its participation in Title IV expires, a letter of engagement from a CPA, and to complete a close-out audit within 90 days. On October 10, 1995, Respondents stated that they had engaged a CPA, but have never submitted the required close-out audits. Meanwhile, SFAP issued its final program review determination for the Mesa school on September 30, 1996, for the Paradise Valley school on February 14, 1997, and for the East Mesa and West Montebello schools on April 9, 1997. Since Respondent schools failed to submit the required full-file reviews, the final program review determinations assessed the schools with total liability for

all Federal funds disbursed to Respondents' students, for a total of \$3,008,843.

## II.

When an institution participates in the Title IV programs, in which it is entrusted to disburse Federal financial assistance to eligible students on behalf of the Federal government, it acts as a fiduciary for the Federal government and, as such, is subject to the highest standard of care in administering the programs and in accounting to ED for any funds disbursed under the programs. 34 C.F.R. §§ 668.82(a) and (b) (1996). In cases where an institution has failed to conduct a full-file review in the face of widespread evidence of noncompliance with program regulations, this tribunal has held that the institution is liable for all Title IV funds disbursed during the period in question, and that such liability is consistent with the institution's fiduciary duty to fully account for all funds expended on behalf of the Department. *National Beauty College*, Docket No. 95-16-SA, U.S. Dept. of Educ. (May 5, 1996); *Louise's Beauty School*, Docket No. 95-48-SP, U.S. Dept. of Educ. (April 17, 1996); *Pan American School, Inc.*, Docket No. 92-118-SP, U.S. Dept. of Educ. (Oct. 18, 1994). Similarly, the failure of an institution to conduct a close-out audit or otherwise account for funds disbursed will lead to a liability on the part of the institution for all Title IV funds disbursed by the institution since the period when the institution last conducted an audit. *Tiffany's College of Hair Design*, Docket No. 96-118-SP, U.S. Dept. of Educ. (July 23, 1997); *Interamerican Business College*, Docket No. 96-20-SP, U.S. Dept. of Educ. (May 28, 1997); *Belzer Yeshiva*, Docket No. 95-55-SP (June 19, 1996); *Puerto Rico Professional Technical College*, 95-144-SP, U.S. Dept. of Educ. (April 11, 1996); *Cosmetology College*, Docket No. 94-96-SP, U.S. Dept. of Educ. (Aug. 23, 1995); *Calvinade Beauty Academy*, Docket No. 93-151-SA, U.S. Dept. of Educ. (March 21, 1995); *Lehigh Technical School*, Docket No. 94-193-SP, U.S. Dept. of Educ. (March 17, 1995); *National Broadcasting School*, Docket No. 94-98-SP, U.S. Dept. of Educ. (December 12, 1994).

Respondents do not challenge their legal obligations to fully account for Title IV funds expended by them during the years at issue, but simply argue that they are unable to perform the full-file reviews necessary in the time period provided. I am not persuaded by Respondents' arguments. Originally, in response to SFAP's demand that the reviews be completed in forty- five days, the Respondents contended that the reviews could not be completed in less than six months, with a possible extension to ten months. Notwithstanding what may have been an obstinate insistence by SFAP that Respondents comply with an unrealistic deadline, by the time that SFAP finally issued its final program review determinations, the Mesa school had more than one year to comply and the other three schools had more than a year and one-half to comply.

The Respondents argue that the seizure of their files by OIG in July 1995 prevented them from having proper access to the files necessary to conduct the reviews. Between July 1995 and January 1997, Respondents' files were located at FBI offices in Los Angeles, and Respondents claim that they could not afford to go to Los Angeles to review the files. In January 1997, at the request of SFAP counsel, the files were moved to Phoenix for the convenience of the Respondents. The Respondents, however, still claim that the files are inaccessible, since they must notify the FBI ahead of time, must identify the files they seek to review, that they have never received a listing of the files seized, and that their review is subject to the availability of an FBI employee to sit with them while the files are being reviewed. While I may find the conditions imposed for the review of the files unacceptable, the Respondents had a full ten months to complete the reviews before the files were seized. And, once the files were seized, Respondents made no apparent attempt to gain better access to the files until after I issued the briefing schedule in this case. Although the Respondents were initially contending that they needed ten months to complete the reviews, in their brief the Respondents are now contending that they need an additional two to three years to complete the reviews. While ten months may be reasonable, two to three years is unreasonable. [See footnote 1<sup>1</sup>](#)

Under the Title IV programs, most schools are allowed to disburse Title IV funds directly to the students. If an audit or other evidence demonstrates problems with the school's disbursements, SFAP may place a school on a reimbursement basis, whereby the school expends its own funds to students and SFAP reimburses the school after it reviews the disbursements. Respondents claim that SFAP owes them reimbursements for eighteen months and that SFAP refuses to "make this assessment in order to not be put in a position of having to pay the School any money it may be owed once all audits and reviews are complete." SFAP's alleged refusal to pay Respondents reimbursements owed to them is not relevant to Respondents' fiduciary duty to fully account for all Title IV funds disbursed by them during the review years

at issue. Given the large and varied violations uncovered by the SFAP reviews, it appears quite reasonable for SFAP to not provide any reimbursements until after the required file reviews and audits are complete.

Based on the totality of the evidence, I am convinced that Respondents have no intention of completing the required reviews and have used every opportunity for delay. Rather than putting adequate resources into completion of the required reviews, Respondents have only one person working part time on the reviews. During a telephone conference with the parties in this case, it became clear that the Respondents were unwilling to allocate any additional resources to the reviews to insure that they are completed in less than two to three years even if provided with full access to the records currently being held at the FBI's office in Phoenix. Thus, I must conclude that the Respondents are liable for all of the Title IV funds disbursed by them since July 1992.

During the years in question, Respondents disbursed \$660,990 in Pell Grant funds. That money must be returned directly to the Department. The Respondents also disbursed \$2,347,853 in Federal Family Education Loans (FFELs). Other than stating that the loan liability must be "remitted," the final program review determinations are unclear as to how this liability may be satisfied. [See footnote 2<sup>2</sup>](#) Respondents may satisfy this liability by purchasing the balances of the loans in question from the current holders of those loans, or paying the Department the estimated loss for those loans using SFAP's estimated loss formula. *See Christian Brothers University*, Docket No. 96-4-SP, U.S. Dept. of Educ. (Jan. 8, 1997).

### **ORDER**

1. Respondents are ordered to repay the Department for Pell Funds expended during the 1992/93 and 1993/94 award years as follows:

East Mesa school \_ \$138,474  
Paradise Valley school \_ \$195,942  
Mesa school \_ \$92,486  
West Montebello school \_ 234,088

2. Respondents are ordered to purchase the remaining balances for all of the Federal Family Education Loans disbursed by them during the 1992/93 and 1993/94 award years, or pay the Department the estimated loss for those loans using SFAP's estimated loss formula.

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Frank K. Krueger, Jr.  
Administrative Judge

Dated: September 30, 1997

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### **SERVICE**

A copy of the attached initial decision was sent by certified mail, return receipt requested to the following:

Mr. Jack King, President  
Classic Beauty Colleges  
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Paul G. Freeborne, Esq.

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*[Footnote: 1](#)<sup>1</sup> Attached to Respondents' supplemental brief are two obtuse letters from "experts" which Respondents argue support their contention that it would take two to three years to complete the file reviews at issue. The first letter is from Mary Clare Swabon, President, Educational Management Consultants, Inc., in which Ms. Swabon provides estimates for completion of "full reconstructions" of files. The files are not identified and it is unclear whether Ms. Swabon's estimate is for one school or all four. Ms. Swabon's estimate appears to be that it would take an expert 6.5 months to complete the reviews if the files are well-organized and one year if the files are not well-organized. Assuming Ms. Swabon's estimate is based on reviewing all four of the Respondent schools, her estimate approximates the amount of time in fact allowed for the reviews.*

*In the second letter, William J. West, Jr., of West and Company, Certified Public Accountants, states that Ms. Swabon's estimates appear reasonable, assuming that the files are in good condition. Again the files are not identified and it is not clear whether Mr. West's statement is based on one school or four. Mr. West goes on to suggest that ED accept a statistical sample in lieu of a review of all the files. Mr. West's suggestion must be rejected since it was a review of a statistical sample by SFAP which uncovered an overwhelming number of violations giving rise to the need for a full-file review.*

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*[Footnote: 2](#)<sup>2</sup> The Department is not, of course, entitled to recover the face value of the FFELs. *Chauffeur's Training School, Inc. v. Riley*, No. 95-CV-1082, slip op. at 11-14 (N.D.N.Y., June 10, 1997).*

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