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

In the Matter of **Docket No. 96-96-ST**

VALLEY COMMERCIAL COLLEGE, Student Financial Assistance Proceeding
Respondent.

Appearances:

J. Andrew Usera, Esq., Vienna, Virginia, for Valley Commercial College.

Denise Morelli, Esq., and Russell Wolff, Esq., Office of the General Counsel, United States Department of Education, Washington, D.C., for Student Financial Assistance Programs.

Before:

Judge Richard F. O'Hair

DECISION

The office of Student Financial Assistance Programs (SFAP) of the U.S. Department of Education (Department), on July 11, 1996, issued a notice of intent to terminate the eligibility of Valley Commercial College (VCC) to participate in the federal student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended (Title IV or HEA). 20 U.S.C. § 1070 *et seq.* and 42 U.S.C. § 2751 *et seq*. VCC filed a request for a hearing on August 2, 1996, and such a hearing was conducted in San Francisco, California, on February 26 and 27, 1997.

The termination notice also informed VCC that SFAP intended to fine it $350,400. The notice explained that the proceeding was based upon the findings of a program review conducted by SFAP's program reviewers. This review found that VCC had failed to pay, and made late payments of, refunds and credit balances to lending institutions and students; failed to implement adequate internal controls over the financial aid process; violated its fiduciary standard of conduct by holding refund checks and misrepresenting their status as having been distributed to the payees; and allowed an unauthorized person to forge the signature of the financial aid officer on Title IV check releases. VCC conceded it experienced cash flow problems between 1992 and 1995, during which time some refunds and credit balances were not timely paid, but, as a result of rigorous internal restructuring, VCC contends it overcame its financial problems and that all refunds and credit balances have been satisfied. It denies the other alleged misconduct and concludes that its infractions are insufficiently serious to warrant a termination and fine.

Institutions which participate in Title IV programs must comply with certain statutory and regulatory financial requirements which subject them to the highest standard of care and diligence in administering the program and in accounting to the Secretary of Education (Secretary) for Title IV funds they receive. 34 C.F.R. §§ 668.82(a) and (b). If an institution fails to meet this high standard of care, the Secretary has the authority to terminate the institution from further participation in the Title IV programs in order to ensure federal funds are not further placed at risk. 34 C.F.R. § 668.82(c); § 668.86(a)(1)(i).

REFUNDS

Title IV requires a participating institution to apply a fair and equitable refund policy pursuant to which it may be required to make a refund of any Title IV funds received on behalf of a student who subsequently withdraws, drops out, or is expelled on or after the first class day. 34 C.F.R. § 668.22(a) (1994). On such occasions, the institution is obligated to calculate and return the Title IV refund to the appropriate program account within 30 days of the date the student officially withdraws, is expelled, or the institution determines that the student has officially withdrawn. 34 C.F.R. § 668.22(g)(2)(iv) (1994). If a refund is allocated to a Federal Family Education Loan (FFEL) program, the institution must pay the refund to the student borrower's lender within 60 days after the student's withdrawal, or within 30 days after the last day of a leave of absence. 34 C.F.R. § 682.607 (1994).

In August 1995, the California Student Aid Commission (CSAC) conducted an investigation of VCC, focusing on complaints that it was not providing timely refunds on loans guaranteed by CSAC. The conclusion of this investigation disclosed that of the 291 refunds owed by VCC on and after July 1, 1993, approximately 175 remained unpaid, even though student files and the "GSL Refund Report" retrieved from the institution's RGM system (a financial aid computer record system to which VCC subscribed) indicated all 291 refunds had been paid. The total amount of unpaid refunds was $175,308.51. CSAC also concluded that virtually all refunds which had been paid during that time period were paid late. Following its investigation, CSAC initiated an action to suspend VCC's participation in all California Educational Loan Programs, and this resulted in the two parties entering a settlement agreement whereby VCC agreed to repay all loan refunds and to pay a $15,000 fine to CSAC.

The Department responded to CSAC's finding by conducting a program review at VCC during October 1995 and January 1996. The reviewers found evidence of a total of 259 unpaid refunds due to Pell Grant, Perkins Loan, and FFEL programs for 1994 through 1996. This conclusion was based on VCC's inability to provide copies of canceled refund checks, the only reliable means SFAP could devise which guaranteed a conclusion that payment had been completed. This finding prompted the reviewers to direct VCC to conduct a full file review for award years 1992-93 through 1995-96. The results of these full file reviews disclosed in excess of 640 late refunds, approximately 80 percent of the refunds due for that period, which totaled over $500,000. Additionally, this documented a failure to timely pay 224 credit balances in the amount of $79,000.

The July 11, 1996, SFAP letter to VCC initiating this termination and fine proceeding addressed the issue of 259 unpaid refunds, 24 late refunds, and late payment of eight credit balances. At the February 26, 1997, hearing, apparently relying on data supplied by VCC documenting the payment of refunds, SFAP reduced the number of unpaid refunds to 56, increased the number of late refunds to 232, and reduced the number of late payment of credit balances to five. With the concession that the bulk of the refunds were paid, SFAP shifted the formerly unpaid refunds into the late paid column because they were paid well beyond their respective 30 or 60 day dates following the students' termination or withdrawal from the school. VCC objects to this treatment, claiming it was not placed on fair notice of the need to defend against a "late payment" versus an "unpaid" charge. This objection is rejected. This hearing addressed the same student refunds, regardless in which column their refunds fell, "late" or "unpaid." After VCC provided evidence of payment of overdue refunds, it should have become readily apparent that the refund was now late. VCC was not prejudiced by this minor amendment of the form of the charge. These "late" and "unpaid" numbers were again amended by SFAP at the time of filing of the post-hearing briefs, presumably in response to evidence provided by VCC at the hearing to the effect that all refunds had been paid to the appropriate parties. Accordingly, SFAP's final position is that VCC owes a refund to one student (Student #258) and made 273 late refunds totaling $232,257.77 on behalf of 219 students.[See footnote 1](#)[1] VCC has provided credible evidence that Student #258 was not owed a refund; however, I am persuaded that VCC paid 273 refunds late.

VCC's owners, Mr. and Mrs. Martin, and the employees in the bookkeeping office acknowledged that VCC frequently delayed its payments of refunds during this time period because it was experiencing a significant cash flow problem. In further aggravation of this practice, SFAP provided evidence that on 38 occasions VCC personnel misrepresented on student file documentation and in the RGM System that the refunds had been paid even though they had not. The procedure VCC followed at that time when a student withdrew or was terminated from the program was for the registrar to send a student action form reflecting this withdrawal/termination to the financial aid office and the

accounting office. The accounting office generated a form showing student hours completed, payments made to the account, any additional charges, and the refund calculation. This form was then sent to the financial aid office for verification with the student ledgers maintained in the RGM system. If the refund calculation were accurate, the financial aid office would send a refund check request form through Mr. Martin to the office which prepared the check. After the refund check was signed, a copy of the front of the check was given to the financial aid office. The accounting office was responsible for mailing the refund checks to the appropriate parties. The misrepresentations occurred when the accounting office, at Mr. Martin's direction, retained the signed checks at VCC rather than mailing them. Meanwhile, the financial aid office, assuming the refund checks had been mailed because they were given copies of those checks, made entries on student ledgers in the RGM system indicating a refund had been paid. These financial aid office employees had no way of knowing that the checks were not timely mailed to the beneficiaries. Their awareness of the non- payments did not develop until they received a rash of telephone calls from disgruntled, confused students who were awaiting expected refunds to their loan accounts. When financial aid employees conveyed these complaints to the accounting office, the usual response became, “[t]he check must have gotten lost in the mail. We'll send out a replacement,” and this was accomplished.

SFAP presented evidence of 38 documented instances of such misrepresentation located within VCC's files. During the hearing, VCC attempted to dispute this allegation of misrepresentation by arguing that its official refund records were not maintained in or by the RGM system which was used in the financial aid office, but rather by an independent data system located in the accounting office. As such, VCC alleges that the reviewers from both CSAC and SFAP improperly relied upon RGM system student refund reports, entitled “GSL Refund Report[s],” obtained for them by VCC employees in the financial aid office when, in fact, the reviewers should have gone to the accounting office for accurate, up-to-date refund data. I give little weight to VCC's argument on this position. Not only did the financial aid personnel believe their refund data was correct, but neither Mr. Martin nor any other school officials raised this alleged disparity until the hearing although they knew, or should have known, at the time of the respective visits upon which data the CSAC and SFAP reviewers were relying when they attempted to decipher the current state of the masses of unpaid/late paid refunds. Additionally, regardless of which school refund report SFAP reviewers utilized, the student ledger cards for these 38 refunds indicated a refund payment date which did not correspond with the actual date of the refund.

The owners explained that their financial problems resulted from the ambitious school expansion program of its physical facilities and resultant cost overruns. VCC also incurred additional, unprogrammed costs which were associated with its transition to a degree granting institution. One of the witnesses testified that she surmised that some of VCC's financial problems were caused by Mr. and Mrs. Martin's lifestyle: they were refinancing and remodeling their house and both drove expensive automobiles. However, once CSAC and SFAP discovered the unpaid refunds, VCC underwent a massive, internal reorganization which included reducing the number of the administrative staff and sharply reducing salaries for its owners, who maintain an active role in the operation of VCC.See footnote 2[2] By the time of the February 26, 1997, hearing, VCC was able to produce reliable documentation to demonstrate to SFAP that all but one refund had been paid, and I have concluded that there was no refund due for that one student.

VCC had a defined fiduciary responsibility set out in the regulations to make refunds to program accounts and to student lender accounts by certain dates. VCC admittedly did not do this, and it was not until after several extensive investigations were conducted and it performed its own file review that all refunds were finally accomplished. No institution, regardless of the financial woes which befall it, even if self-imposed, such as VCC's embarkation on a facilities expansion program, has the inherent authority to daily massage its Title IV funds in such a way as to maximize its unauthorized retention of those same funds. Doing so violates the regulation and increases the costs of Title IV funds to the Department, as well as to the students who are the intended, primary beneficiaries of these programs. VCC's transgressions are mitigated somewhat by virtue of the fact it has paid all refunds and has reimbursed the Department for the interest charges allocated to the late payment of those same refunds; however, I am unable to conclude that this act of restitution completely erases the past. Institutions participating in Title IV programs agree to abide by some very stringent fiduciary guidelines, and it is intolerable for those institutions to view these guidelines with nonchalance and attempt to explain violations in terms of doing so to keep the institution solvent, or maybe to enhance its programs or facilities. The Title IV program was not implemented to serve as a floating loan for educational institutions and when it is used as such, the beneficiary's participation should be terminated. VCC's failure to abide by its fiduciary duties to the Department causes it to fall into this category, and the consequence should be termination.

CREDIT BALANCES

Institutions which participate in the Pell Grant program incur fiduciary responsibilities similar to those imposed on them by the student loan programs. 34 C.F.R. § 668.82(a). Accordingly, when an institution's students are authorized to receive Pell Grant funds which are in excess of their cost of attendance, the institution must either return the excess funds to the students or, with the permission of the students, the institution may retain the credit balance to apply it to future institutional charges. 34 C.F.R. § 690.78(a) (1993). These funds are held in trust for the student beneficiaries and may not be used for any other purpose. 34 C.F.R. § 690.81(c) (1993). If the students are no longer enrolled in the institution and unlocatable, apparently the Department will accept the payment of the credit balance to the lender holding the students' FFEL loan or Perkins debts. Institutions cannot make payments of these credit balances back to the institution's own Pell account, as this does not benefit the students, but only the institution.

SFAP reviewers reported eight instances in which VCC improperly delayed the payment of credit balances to its students, thus presumably depriving these students of funds which they would have found useful as they pursued their educational program at VCC. Before the hearing, SFAP withdrew this allegation with respect to three of the students, leaving only students #262, #265,#269, #279, and #286 under this finding. VCC was unable to satisfactorily show that its payments of credit balances to these five were made in a timely fashion; and its file reviews of its accounts disclosed the payment of 226 late credit balances for 201 students. VCC has made assurances, however, that it has revamped its internal procedures to preclude any future violations in this area. Once again, VCC used available, excess student funds to prop up its financial operations during the periods it found itself short of cash, overlooking the fact that it was obligated to hold these funds in trust for the student beneficiaries.

INADEQUATE INTERNAL CONTROLS

One of the key features of participating in any Title IV, HEA program is that the institution must demonstrate it is capable of adequately administering the program. 34 C.F.R. § 668.14 (1993)[See footnote 3][3]. This necessarily includes the requirement that a system of adequate checks and balances be applied within its system of internal controls. This mandates there be a division of the functions of authorizing federal student financial aid payments and the disbursing or delivering of those funds so that no office has responsibility for both functions. 34 C.F.R. § 668.14(d). This division of functions within an institution minimizes the possibility that a school administrator will misuse federal funds by allocating them to unauthorized purposes or to ineligible students.

The termination letter alleged generally that VCC did not have the required system of internal controls in that Mr. Martin “participated extensively in both the functions related to authorizing payments and the functions related to disbursing funds.” Evidence that Mr. Martin was involved in the authorization of payments was presented by a former VCC director of financial aid who recounted several instances in which Mr. Martin had overridden her financial aid packages for students by adding student loans for which she believed the students were not eligible. On the disbursing end, VCC employees also testified regarding instances where Mr. Martin insisted that loan funds be released prematurely even though specific time or attendance requirements had not been satisfied. VCC objected to SFAP's introduction of these specific allegations or violations of federal law which it says were not included in the program review, termination notice, or SFAP's initial brief. I disagree. The section of the July 11, 1996, termination notice which addresses inadequate internal controls, referenced the following as examples of Mr. Martin's extensive participation in both authorizing payments and disbursing funds: determination of students' Title IV, HEA eligibility, monitoring students' academic progress, disbursement of program funds, and all program refund and fiscal functions. SFAP's witnesses properly provided the specifics to support these general allegations. Further support comes from the program reviewer's conclusion that Mr. Martin had a “free hand” in all financial aid matters. SFAP presented credible evidence that Mr. Martin extensively participated in both the fiscal process and the programmatic functions of the Title IV program operations at VCC, from the assembly of student aid packages to the timing of the student aid refunds. Certainly there will be more involvement in the Title IV program by the proprietor of a small institution than of a larger one, by virtue of the fewer numbers of students and administrators. On this point I agree with VCC that, “as an owner, Mr. Martin had a supervisory role over all departments of the school....” Nonetheless, regardless of the size of an institution, proprietors must scrupulously employ competent, trained individuals to perform these roles and the proprietors must strictly limit the scope of their involvement in Title IV programs to monitor only the employees'

performance. Proprietors cannot substitute their decisions on Title IV matters for those of their employees and still maintain the system of checks and balances which is demanded by the regulations. VCC has implemented a plan to remedy this deficiency, to include retaining an experienced financial aid consultant in 1995 as its reimbursement agent and compliance specialist who explained that VCC had a very effective system of checks and balances in place. However, at the time of the program review, such a division of functions was not in operation and VCC did not maintain adequate internal controls.

FIDUCIARY STANDARDS OF CONDUCT

A predominant theme of the operation of the Title IV program is that an institution must administer these programs in the capacity of a fiduciary. This means it is subject to the highest standards of care and diligence in accounting for the funds received under the program. 34 C.F.R. §§ 668.82(a) and (b) (1993). SFAP provided evidence that VCC failed to meet its standard of care in a number of circumstances. One example is where Mr. Martin personally manipulated the timing of the payment of student refunds and credit balances to suit the financial needs of the institution, rather than to comply with the requirements of the regulations, as discussed above. Mr. Martin authorized the preparation of refund checks which he ordered be retained and not mailed, but permitted VCC employees to annotate student ledgers to indicate the refunds had been made. The mailing of the refund checks apparently was delayed until either VCC was financially able to cover them, or an outside inquiry was made as to the status of the refund.

Further evidence of VCC's breakdown in its adherence to its fiduciary responsibilities occurred when Mr. Martin's daughter, who, at the time was not certified as a financial aid officer, was permitted to forge the signature of VCC's director of financial aid on over 100 VCC student loan disbursement release forms in the loan authorization section. The form requires the signature of a school official immediately below the signature of the student borrower. This section of the form provides instructions from the student to the institution as to how the loan proceeds should be distributed, and it serves as an acknowledgment that the student borrower was fully informed about the loan process. VCC vigorously defends this allegation by noting that Ms. Martin had been given permission to sign the forms, and that these forms were not federally mandated documents, but internally generated for VCC's purposes. I find that Ms. Martin did not have the authority to sign these loan disbursement forms, but I consider these to be a fairly minor infraction, but indicative of the casualness with which VCC approached its overall fiduciary obligations and its willingness to speed up the financial aid process if that meant financial aid funds would be more quickly placed at its disposal.

CONCLUSION

Having decided that over the course of several years VCC purposefully withheld loan refunds and credit balances past their due date for the singular purpose of relieving its self- inflicted cash flow dilemma, maintained inadequate internal controls, and failed to meet its fiduciary standard of care, I find that termination of VCC's Title IV eligibility is appropriate. In addition to termination, an institution may be fined up to $25,000 as punishment for each of its violations of the Title IV program requirements. 34 C.F.R. § 668.84. SFAP also asks that I find that VCC should also be fined $182,800. This figure represents $1,000 for the one unpaid loan refund which I have found was in error; $700 for each of the late refunds to 219 students ($153,300); $700 for each of the five late paid credit balances ($3500); and $25,000 for the school's failure to maintain adequate checks and balances within its system of internal controls. The imposition of a fine is a subjective determination which is premised upon the volitional character of the offense, the seriousness of the offense, and other mitigating circumstances, such as whether the violation represents a repeat finding, and the size of the institution. 34 C.F.R. § 668.92. I have determined that, based on the amount of Pell Grants VCC received, it is a large, as opposed to small, school and that VCC intentionally misappropriated Title IV funds to its advantage, a situation which was facilitated by the lack of strict internal controls. This is tempered by my conclusion that, contrary to SFAP's assertion, a termination exacts a certain amount of punishment upon the affected institution.[See footnote 4][4] I have also taken into consideration that VCC has already paid a fine of $15,000 to CSAC for essentially the same misconduct allegations. Accordingly, I find a fine of $49,800 is appropriate. This results from a fine of $200 for each of the late payment of refunds for 219 students ($43,800); $200 for each of the improperly and late paid credit balances ($1,000); and $5,000 for the failure to maintain adequate internal controls.

FINDINGS

1. VCC was late in paying 273 refunds on behalf of 219 students to lending institutions.

2. VCC was late in paying credit balances to five students.

3. VCC violated its fiduciary standard of conduct by not implementing adequate internal controls, by retaining refund checks and misrepresenting their status as having been distributed to payees, and by allowing an unauthorized person to forge the signature of a financial aid officer on Title IV check releases.

ORDER

On the basis of the foregoing, it is hereby ORDERED that the eligibility of Valley Commercial College to participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965 be terminated and that Valley Commercial College pay a fine of $49,800.

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Judge Richard F. O'Hair

Dated: June 17, 1997

SERVICE

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

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Footnote: 1 [1] *In some instances there was more than one late refund violation for each student.*

Footnote: 2 [2] *The VCC employee who initially raised the complaint of unpaid refunds with CSAC testified she was subsequently released from employment with VCC on the day after the CSAC visit. She was given the explanation that VCC could no longer afford to employ her because it now had to pay all of the unpaid refunds.*

Footnote: 3 [3] *This provision was moved to 34 C.F.R. § 668.16 in 1994.*

Footnote: 4 [4] *See, In re Universidad Federico Henriquez Y Carvajal, Dkt. No. 96-16-ST, U.S. Dep't of Educ. (Dec. 16, 1996); In re Art of Beauty College, Dkt. No. 95-72-S, U.S. Dep't of Educ. (Aug. 31, 1995).*