

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

In the Matter of

**NORTH CAROLINA ACADEMY OF
COSMETIC ART,**

Respondent.

Docket No. 98-123-EA

Docket No. 98-129-ST

Student Financial

Assistance Proceeding

Appearances:

Ronald L. Holt, Esq., Watkins, Boulware, Lucas, Miner, Murphy & Taylor, LLP, of Kansas City, Missouri, for Respondent.

Alexandra Gil-Montero, Esq., and Russell B. 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 North Carolina Academy of Cosmetic Art (NCACA) is a proprietary, clock hour educational institution located in Asheville, North Carolina, which participates in several student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended (Title IV), specifically the Pell Grant Program and the Federal Family Education Loan (FFEL) Program. 20 U.S.C. § 1070 *et seq.* and 42 U.S.C. § 2751 *et seq.* On August 20, 1998, the office of Student Financial Assistance Programs (SFAP) of the U.S. Department of Education (Department) notified NCACA that it was imposing an emergency action against it under the authority of 20 U.S.C. § 1094(c)(1)(G) and the procedures found at 34 C.F.R. § 668.83(1997). As a result of this emergency action, the Department withheld Title IV funds from NCACA and its students and withdrew NCACA's authority to obligate Title IV funds under any student financial aid programs. On the same date, SFAP also notified NCACA that it intended to terminate the eligibility of the school to participate in any programs authorized under Title IV (20 U.S.C. § 1094(c)(1)(F); 34 C.F.R. § 668.86) and fine it \$225,000. NCACA exercised its prerogative to request a hearing on these two administrative adverse actions and I conducted a joint hearing to address both actions in Asheville, North Carolina, on October 15 and 16, 1998, and in Washington, D.C. on October 28, 1998.

Both proceedings were predicated upon a finding that between January and May 1998 NCACA's director engaged in serious breaches of the institution's fiduciary responsibility to the Department by falsifying attendance records for nine of its students who had been awarded Title IV funds. More specifically, SFAP accused the director of falsely and fraudulently crediting attendance hours for three students who had enrolled in NCACA but who had not attended any classes, and for crediting attendance hours to six students after they dropped out of the program and had discontinued their attendance. NCACA admits that its director committed these fraudulent acts, and it has reimbursed the Department for the incorrectly awarded Title IV funds. Furthermore, it maintains that it has made appropriate administrative corrections to its operation that support its position that its Title IV funding should be reinstated.

SFAP imposes an emergency action on an institution as an immediate, yet temporary, means of preventing the misuse of Title IV funds while the two parties ready their case for the more comprehensive termination proceeding. If the emergency action is not previously revoked, it ceases to exist once the termination proceeding is complete. From a procedural standpoint, the present case differs from the ordinary because it combines both an emergency action and a termination action into one proceeding. In the typical emergency action show cause proceeding, the institution has the burden of persuading the tribunal that the emergency action is unwarranted. 34 C.F.R. § 668.83(e)(4). In a termination proceeding, however, the Department carries the burden of persuasion, which means it must prove that the institution committed the statutory or regulatory violations alleged and, as a result, should be terminated and/or fined. 34 C.F.R. § 668.88(c)(2). SFAP agreed to be the first to present its evidence in this evidentiary proceeding, thus allowing NCACA to respond; however, it was understood that both parties retained their respective burdens of persuasion for the two original proceedings.

FACTS

SFAP's evidence consisted of the following stipulations of fact. NCACA was owned by Henderson Education, Inc., a company jointly owned by Frank Jennings and James Howard. Mr. Jennings's wife, Paula Jennings, was employed as the director of NCACA from 1994 to August 1998. In August 1998 Cathy Lane, formerly a Title IV financial aid consultant with Weber & Associates (a third-party Title IV financial aid processor and consultant approved by the Department), was hired as acting director and continues in that capacity. The North Carolina State Board of Cosmetic Art Examiners (State Board) conducted an on-site inspection of NCACA during the week of June 1, 1998, and the Department conducted a program review at NCACA from July 13 - 20, 1998. The inspection and program review confirmed that Paula Jennings prepared false reports of student hours of attendance for three students who had interviewed with NCACA but never attended classes there, and for six other students who withdrew from the school before completing their program of study. The purpose of these false student attendance reports was to obtain federal Title IV funds on behalf of these nine students. As a result of these false reports, NCACA wrongfully received \$8,462 of Pell Grant funds. NCACA has returned all of these funds to the Department.

NCACA presented evidence that it is a small school, with an excellent reputation, offering courses in cosmetology and manicures, and that during the first half of 1998 had about 60-80 students enrolled at any one time. Its owners deny having any knowledge of, or condoning in any way, the unauthorized actions on the part of Paula Jennings in the fabrication of student attendance records which resulted in an increase of the amount of Title IV funds to which it would otherwise not have been entitled. After this revelation was brought to their attention, the owners implemented a number of steps, including the verification of the problem, terminating Mrs. Jennings' employment, making appropriate reimbursements to the Department and modifying attendance procedures to prevent a recurrence of this situation.

The first step in this procedure was to retain the services of Glen Bogart, an experienced Title IV compliance consultant, who testified that he confirmed the Department's findings that there were instances of nine students who had attendance hours improperly credited to their records. He also examined NCACA's financial records, including bank statements, and concluded there was no unusual movement of funds during this time period which would indicate that any person realized a financial bonanza as a result of the false attendance records. He concluded that NCACA's records supported the findings of the Department and he initiated steps for the school to return the improper Pell Grant funds. He admitted that it is hard to detect fraud in student attendance record keeping and that if it previously had not been brought to his attention, he probably would not have detected it during his review.

As was explained by NCACA witnesses at the hearing, the school has three alternative methods for recording student attendance:

1. Hour Book -- this book is maintained by the school director and in it the director recorded daily attendance hours, as well as a running balance of each student's cumulative hours spent at the beauty school. The source documents for these figures are student time cards. These cards are punched by a time clock upon the student's arrival and departure and record a week's worth of hours. The time clock is a state required method of accounting for student attendance and NCACA's time clock was located in a prominent area of the school facility.

2. Roll Book -- this book is maintained by the instructors who teach the state- required 300 hours of theory to the students. Students are encouraged to attend a theory class every day they attend the school; however, it is possible for a student to be in attendance elsewhere in the school and not have attended a theory class on that particular day.

3. Patron Log/Sign-In Sheets -- these sheets are annotated daily in the school's beauty salon and include the name of customers who have had cosmetic services performed and the name of the student providing the services.

Mr. Bogart examined these school record keeping procedures, which he found to be comparable to the systems used by other small cosmetology schools such as NCACA, and the school adopted several of his recommendations to make them more accountable. These recommendations included placing typed names and dates on each of the time cards, having students and instructors sign the time cards, and removing time cards of absent students from the theory classroom, thus requiring the absent student to retrieve the card from the director when the student next attended class. Mr. Bogart did not examine the Patron Log/Sign-In Sheets and he found that the integrity of Roll Books has not been challenged. Therefore, he made no recommendations for changes of procedure for either of those records.

A CPA testified that his firm has prepared NCACA's recent audits and it has found no discrepancies in the school's compliance with relevant laws and regulations. The firm looks only at the time cards and the Hour Book and from this the only discrepancy it found was a lack of timeliness of posting records. The witness was familiar with the new attendance recording procedures the school implemented and thought they would enhance the reliability of its attendance records, although he admitted that an auditor must rely on the integrity of the records the school submits.

Frank Jennings, one of the owners, testified that he has 23 years of experience in the field of education. He explained that NCACA offers a 1500 hour cosmetology program, and an 800 hour cosmetology instructor program and a 200 hour manicuring program. Mr. Jennings and Mr. Howard acquired NCACA in 1993, and since that time each has contributed approximately \$100,000 to the partnership. At the time of purchase the school was licensed, but unaccredited. It obtained accreditation within a year and then applied for Title IV eligibility which was first awarded provisionally, but it now has full certification. It employs the services of a third-party servicer, Weber and Associates, which, after examining the students' financial aid applications and supporting documents, determines eligibility and orders the appropriate Title IV funds. Mr. Jennings was not a regular NCACA employee at first, but was present in the facility during much of the time performing an array of custodial duties for the school, in addition to transporting Title IV documents to and from Webber & Associates, and assisting both his wife with some of her responsibilities, as well as Janis Pitman, an experienced financial aid person they hired in January 1998. In October 1997 he began drawing a salary of \$250 every two weeks when he began devoting a lot of his time to preparing for the school's reaccreditation. He ceased drawing a salary in June 1998 when the false attendance records were discovered. As the president of the school, he has the overall responsibility for the operation of the school, and as the signer of the Program Participation Agreement with the Department, he acts as a fiduciary of Title IV funds on behalf of the Department. He did not personally occupy either of the two administrative offices at the school, but shared space in them when needed. His wife and he frequently discussed the school operation and shared school ideas and problems, but he denied involvement in the day-to- day operations of the school.

Mr. Jennings testified that he thought NCACA was properly handling its attendance requirements, not only from his own experience and observations, but also from the absence of any suggestion from its accrediting agency that a change in procedures was recommended. Not until the June 1998 visit from the State Board did he learn that this agency was disappointed with the accuracy and timeliness of the reporting of the school's attendance records. At no time prior to this did any employee at the school, including Ms. Pitman, ever bring any attendance record improprieties to his attention. It was school policy, as far as he knew, to always wait until a student actually started to attend classes before the student's Pell Grant paperwork was forwarded to their servicer to begin payments. Ms. Pitman was hired in January 1998 to work as the financial aid administrator, a role his wife previously assumed. Ms. Pitman left in June 1998, several weeks after she complained to both the Department and the State Board regarding his wife's false attendance records. When she resigned, Ms. Pitman said nothing to him about any false paperwork, but only explained that she could no longer work

with his wife. It was some time after Ms. Pitman left that Mr. Jennings learned that she had reported these irregularities to the several authorities.

Mr. Jennings and Mr. Howard discussed the operation of the school every three to six months and both had access to weekly site director reports which contained data regarding the number of currently enrolled students and amounts of financial aid disbursements. Mr. Howard drew no salary from the school and neither gentleman has received any dividends or other financial rewards from their corporation. Mr. Howard was shocked to hear of the false reports prepared by Mrs. Jennings, whom he has known for 27 years. He knew she was on medication, but thought she was fine, and he never questioned her integrity. He and Mr. Jennings had previously discussed the possibility of the latter leaving the school and becoming a non-participating director in an attempt to preserve the school's Title IV eligibility.

NCACA's two owners hired Paula Jennings, the wife of Frank Jennings for 32 years, as the school's director in May 1995. Mrs. Jennings has a bachelor of arts degree and was formerly a teacher. She received training in matters regarding student financial aid from Webber & Associates and from an auditor. Initially her salary was \$30,000 per year and this was increased to \$36,000 in October 1997; she received no commissions. Mrs. Jennings' role as director included interviewing prospective students, supervising their completion of all necessary forms, and acquiring Title IV supporting materials; she supervised the instructional staff; paid all bills; and was the sole person to maintain the school's Hour Book. She also attended the regular meetings of NCACA's accrediting agency, and recently it asked her to be a member of its peer review committee. As such, she accompanied the committee to examine other schools which were seeking reaccreditation. The accrediting agency never reported it had any concern or complaints about her performance during these visits and any meetings she attended.

Prior to purchasing NCACA, Mr. Jennings was aware that his wife had a medical problem which was diagnosed as a bi-polar personality. They were in Texas when it was first diagnosed and her physician prescribed medications which significantly improved her behavior. When they moved to North Carolina she sought the assistance of a local psychiatrist who confirmed the diagnosis and continued the medication needed to treat it. Unbeknownst to him until just recently, his wife ceased taking this medication on a regular basis in January 1998 and subsequent to that time she took it only when she felt she needed it. He noticed that she was under obvious stress when NCACA moved to a new location in August 1997 and when he mentioned this to her, she "laughed it off." He never witnessed her in a delusional state or engaging in any unlawful behavior, such as punching time cards for students. Mr. Jennings and Mr. Howard terminated her employment as NCACA's director in August 1998. Since then she has been hospitalized twice and is currently at home and is not working. Mr. Jennings said NCACA has no intention of re-hiring her and he does not discuss school business with her.

The State Board is required to perform quarterly visits to cosmetology schools for the purposes of ensuring adherence to sanitation measures and that attendance record keeping is accurate. The State Board inspectors have previously noted problems with NCACA's record keeping function in terms of accuracy and timeliness, and during their visits the inspectors corrected these errors before departing the school. It was not until the most recent review in September 1998 that the State Board accused the school of "continuously" violating their record keeping rules and concluded by informing the school it would not "tolerate these constant violations."

Elaine Wright testified that she is one of the school's three classroom and theory instructors and, like the other instructors, was responsible for annotating the attendance Roll Book. On occasions when a student forgot to have his or her time card punched by the time clock, she would do this for the student, provided she was confident the student had been in attendance on the day in question. She denied having been asked by Mrs. Jennings to sign or punch in a student's time card. She frequently encountered Janis Pitman at work, but Ms. Wright never discussed financial aid with her, or with anyone else. Once she witnessed Mrs. Jennings engage in some harsh counseling of Ms. Pitman because of some incompetence in her work. Ms. Wright said Mrs. Jennings was not deceptive or misleading and she never saw her punching time cards for absent students. Ms. Wright denied that Karen Goransen, a former instructor at NCACA, asked her to fill in student cards or complained to her about Mrs. Jennings allegedly falsely signing in students. She knew that Ms. Goransen was asked to leave the school because she was teaching cosmetology, but did not have the appropriate credentials, and that she was upset about the loss of her job.

The new acting director of the school, Cathy Lane, testified that she has been employed by the school since August

17, 1998. She was previously employed as a financial aid services manager with Weber & Associates, and she has fifteen years experience in the student financial aid field. She has no prior experience in operating a cosmetology school, but she is learning that the state has some very rigid record keeping requirements. She was aware of the student attendance discrepancies when she was hired as acting director, and one of her first tasks was to audit the 1997-98 student records to determine if there were any other problems. She has implemented procedural changes regarding placing the names and dates on the attendance cards, as well as the policy of retrieving the cards of absent students. No new students have been enrolled since the imposition of the emergency action, even though some of them would be cash-paying students. She has compiled a list of students who have earned Pell Grants and are ready for payment, but these files have not been submitted because of the emergency action.

Ms. Lane was present during the September visit by State Board inspectors. In the area of sanitation, they found one discrepancy regarding the vents in the bathrooms. In the record keeping section, the reviewers found a number of errors, such as giving one student more than the allowable eight hours for one day; improperly crediting a student for work on the beauty floor before she had completed the minimum of 300 class hours; improper rounding up or down of fractions of hours in the Hour Book; and untimely State Board notification of changes in the teaching staff. The inspectors made all necessary corrections and told her that overall the school was improving in its record keeping.

The internal audit she prepared for the owners required that she review the financial aid payments, plus attendance figures from the attendance cards, Hour Book, and Roll Book, but not the customer floor book. She did not find any incidents where she had attendance cards for students and was unable to locate any entries for the student in the Roll Book. From these records she determined the last day of attendance for the approximately 84 files of students who had dropped the program. For each student she then compared the last day of attendance recorded in the Roll Book and computed a refund, even though the Hour Book may have shown the last day of attendance to be on a later date. Using this most conservative method of calculating refunds, as of the commencement of the October 15-16 hearing, out of 67 files reviewed she determined that a relatively small refund was due for approximately 16 students, which amounted to \$16,048. She explained this was just a preliminary figure and that her next step would be to attempt to contact each of these students and obtain a statement from them as to their recollection of their last day of attendance. If this date agrees with the date in the Hour Book, then this would confirm that the Hour Book was correct and no refund would be due any party.

In rebuttal, SFAP called Susan Pursley, an inspector for the North Carolina State Board of Cosmetic Art Examiners, to describe her state inspections/visits to NCACA in August and December 1997, as well as in February, May, June and September 1998. On each of these visits she noted and corrected record keeping discrepancies, many of them repeat violations, caused mostly by inattentiveness and carelessness on the part of the director, the person responsible for maintaining the Hour Book. She also noted the school had a history of a general lack of good filing procedures which often made it more difficult to locate all of the records she needed to see. It was her opinion that, aside from the false records she found during the June 1998 school audit, which was shared with the Department, the record keeping at the school was inadequate during the entire time Mrs. Jennings was in charge. Part of the problems discovered during the September visit existed because Ms. Lane is a new employee and not knowledgeable about the many State Board record keeping and reporting requirements. Ms. Pursley perceived Mrs. Jennings' departure from the school as a positive event, but surmised that administrative problems still exist. She has the impression that Ms. Lane is cooperative and is anxious to work with the State Board to bring the school into complete compliance and she has no reason to doubt her ability.

The June 2-5, 1998, audit at NCACA was precipitated by complaints from two persons. The first was from Karen Goransen who told the State Board that she had received cosmetology instructor training at NCACA, but that the school insisted it had no record of any such training. The second complaint was from Ms. Pitman who provided the State Board with a list of specific students for whom it was alleged Mrs. Jennings had fabricated attendance records, along with copies of hour books pages which supported her allegation.

Karen Goransen testified she was a former manicurist instructor and later a cosmetics instructor at NCACA, but in May 1998 Mr. Jennings terminated her employment because the State Board informed him that she did not have a beautician instructor license. Ms. Goransen contends that she received the necessary cosmetics instructor training at NCACA, but the school disputes this point. Shortly after Ms. Goransen ceased working at NCACA she reported to the State Board that she had witnessed Mrs. Jennings engaging in student attendance fraud. This included witnessing her

clock in students' time cards on three occasions in 1997 and "many" times in 1998. As far as she can remember, Mr. Jennings was around most of the times that these events occurred. Additionally, three students complained to her that they had seen Mrs. Jennings and their instructor, Elaine Wright, clocking in students. When Ms. Goransen mentioned this to Ms. Wright, the latter admitted she did it only when Mrs. Jennings told her to. Ms. Goransen also mentioned these complaints to Mrs. Jennings, who was non-committal in her reaction to the students' complaints. On another occasion, Ms. Goransen saw a note from one of the students taped to Mrs. Jennings' door in which the student reminded Mrs. Jennings -- "Don't forget to clock me in." During 1998 Ms. Goransen regularly saw Mr. Jennings in and around the school and she noticed tension between him and his wife about school matters which was exhibited through arguments between them behind closed doors. Ms. Goransen also elaborated about a dispute she had with the school which developed because she insisted she had been enrolled in their cosmetician instructor's course but the Jennings had insisted she had not. The school has no record of her having paid tuition for this course and this, she explained, was because Mrs. Jennings had told her she would waive the course tuition fee which was several thousand dollars. The State Board also did not have any record of her attendance at this course. Only her course instructor, who is a former employee of the school, supports Ms. Goransen's claim of having completed the course. Ms. Goransen denied falsifying any student attendance records, and she was never asked by either of the Jennings to falsify records.

SFAP's final witness was Janis Pitman, who worked as the financial aid officer from January to June 1998. Her responsibilities included interviewing prospective students, preparing Pell Grant applications, posting accounts receivable, completing State Board paperwork, and computing hours recorded by students on the time cards. She worked in an office adjacent to that of Mrs. Jennings', with whom she had daily contact. Ms. Pitman had no access to, and did no work with, the school's Hour Book. That was solely Mrs. Jennings' responsibility. Mrs. Jennings checked the time card hour totals and then entered these hours in the Hour Book. Ms. Pitman saw Mrs. Jennings punch in student time cards on two separate occasions and she was certain Mr. Jennings was in the building at those times. This happened during the morning hours while students were present in the school. She also saw time cards containing student names and hours in Mrs. Jennings' desk drawer on more than one occasion. For these reasons, she believes Mr. Jennings should have seen, or at least realized, that his wife was falsifying student records. Ms. Pitman did not tell either Mr. Jennings or Mr. Howard about Mrs. Jennings' falsifications because she did not feel comfortable about bringing this to their attention.

Ms. Pitman recalls that Mr. Jennings was in the office every day and frequently used either her or his wife's desk for short periods of time. Most frequently he was concerned about the status of a student's hours to determine if the student had earned more Pell Grant funds. To assist him she would obtain the Roll Book to see who had attended. She thought they should be using the Hour Book because it was supposed to be the official attendance book, but Mr. Jennings disagreed, saying his wife did not keep it up correctly. [See footnote 1*](#) When the school was preparing for the June audit, Mr. Jennings remarked that there appeared to be a large number of students dropping out at the 160-170 hour level of the program and that he would have to speak to the instructors about this problem. His remark made Ms. Pitman suspicious because when a student drops out of a program after completing approximately that number of hours, the school normally does not have to compute and pay a refund. Mrs. Jennings discussed all major school issues with her husband and he made the ultimate decisions on those matters. Frequently the two of them argued behind closed doors about school issues. Mr. Jennings' responsibilities also included performing minor building maintenance, such as changing locks on student lockers after a student departed and removing trash from the building. Ms. Pitman quit working there in June 1998 because of the irregularities and confusion in the record keeping at the school. When asked, she told Mr. Jennings that she could not stand the tension of working with his wife any longer. At one point, Mrs. Jennings was complaining about some error and she told Ms. Pitman she was stupid, but she later apologized. On several other occasions Mrs. Jennings asked her to sign and send student "start sheets" (forms which indicated the beginning of classes for new students) to their servicer so that Pell Grant payments could begin even though Ms. Pitman knew the students had not started classes as of that date. Ms. Pitman mentioned this fact to her, but there was no change in the request. Mrs. Jennings was also responsible for the refund calculations for students who dropped out, and Ms. Pitman did not believe she needed to remind her to calculate refunds for the dropouts, since Mrs. Jennings was very familiar with financial aid rules.

Several weeks before she quit her job with NCACA, Ms. Pitman called the State Board and the Department's regional office in Atlanta to report the record keeping discrepancies. Subsequently she gave the State Board inspectors a list of students who had dropped out of school, but for whom Mrs. Jennings had not calculated appropriate refunds.

At the conclusion of the evidentiary hearing on October 16, 1998, NCACA submitted Respondent's Exhibit - 56, a draft of an uncompleted, self-conducted audit of all 1997-98 students who received Title IV aid and who did not complete the program. Ms. Lane explained that, to date, the conservative audit disclosed that she was unable to verify student attendance which represented approximately \$16,048.29 in Title IV disbursements. She further explained that she anticipated having the audit completed by October 23. Coincidental with the Tribunal hearing closing arguments from counsel on October 28, 1998, NCACA submitted Respondent's Exhibit - 53-B which is the October 28, 1998, Internal Audit Report of Dropped Students With Record Issues. This document increased the amount of potential refunds owed by NCACA to \$21,549.31. SFAP challenged the accuracy of this document by submitting several lists containing approximately 14 students who it argues also should have been included in the school's Internal Audit Report.

The final exhibits submitted to the tribunal by NCACA on November 2, 1998, include two documents to which counsel for NCACA alluded during closing arguments. These documents indicate that on October 28, 1998, the two owners of NCACA agreed that Mr. Jennings should no longer be one of the two Directors of the corporation and that for the next year Mr. Howard and Ms. Lane will serve in that capacity. Additionally, Frank Jennings will not be serving as an officer for the next 12 months. NCACA informed the tribunal that if the emergency action were to be lifted, it agrees to remain on the reimbursement basis of receiving Title IV funds and to utilize a Student Verification form on which students would be asked to verify their school attendance data. Furthermore, counsel for NCACA has represented that if the emergency action is lifted, the owners will seek approval from SFAP for Mr. Howard to purchase Mr. Jennings' ownership interest in Henderson Education, Inc.

DISCUSSION

This hearing combined NCACA's challenge to both the emergency action and the termination and fine proceedings, and each has its own burdens of persuasion. The respondent carries the burden in the former and SFAP carries it in the latter. After reviewing the evidence, the tribunal has concluded that NCACA has not persuaded it that the emergency action should be revoked and SFAP has not persuaded it that NCACA's Title IV eligibility should be immediately terminated. The more appropriate disposition of this adversarial proceeding lies somewhere between the extreme positions naturally taken by these two parties.

The Title IV programs, and the Postsecondary, Adult, and Vocational Education Division of the Department of Education, exist for the purpose of assisting postsecondary students to obtain their desired level of education. Title IV facilitates this through the medium of federal student aid which is funneled to students through hundreds of postsecondary educational institutions such as NCACA. The determination of student aid eligibility and transfer of student aid funds requires participating educational institutions to agree to maintain a fiduciary relationship with the Department with regard to these monies because the magnitude of the Title IV program does not permit the Department to monitor these particulars for every eligible student. Once a school has been determined to be eligible to disburse Title IV funds, the Department assumes the school is honest in its application of Title IV rules, and this trusting relationship continues until the school acts inappropriately and causes the Department to lose its faith in the integrity of the school. That is what occurred with regard to NCACA. Until June 1998 the Department had no reason to question that NCACA was complying with its fiduciary obligation to disburse aid only to eligible students. The June program audit by the State Board, followed by a similar review by SFAP, erased this prevailing sense of trust and confidence. To determine NCACA's future relationship with SFAP, one must address several questions. The first question is whether the confirmed misconduct was perpetrated solely by Paula Jennings and to what extent it should be attributed to the school owners and any other employees. The next question or issue is whether the school has initiated sufficient corrective measures to assure SFAP that the disbursement of future Title IV funds will not be at risk of being similarly misappropriated. And finally, if the answer to the previous question is affirmative, is the true intent and purpose of the Title IV program, providing educational opportunities for students, best advanced by permanently terminating NCACA's Title IV eligibility?

Upon the discovery of the false attendance figures, Glen Bogart verified those findings and then expanded his examination and found no evidence to suggest any other inappropriate payments either to the owners or any outsiders. Following this verification, NCACA terminated Mrs. Jennings' employment as director, and both parties to this

proceeding have stipulated that she prepared the false reports of student hours of attendance. SFAP makes an extension of this and now argues that termination of NCACA's eligibility is appropriate, among other reasons, because Frank Jennings either knew, or should have known, that Paula Jennings was consistently making false entries on students' attendance cards. Even though no one ever saw Mr. Jennings engaging in this activity or heard him and his wife discussing such a ploy, the most incriminating evidence is that Mr. Jennings was present at the school on an almost daily basis during the first half of 1998 when most of this misconduct occurred. He could hardly have avoided observing his wife make the hundreds of trips to the time clock she would have had to make to obtain sufficient time clock entries on the nine time cards at issue to entitle the school to the unauthorized Title IV funds it received. Therefore, even though Mrs. Jennings has been removed as director and no longer has any direct connection with the school, and Mr. Jennings is no longer a director or an officer in the parent corporation, he retains an ownership relationship with NCACA. Apparently even that relationship may be severed in the future because the two owners are discussing the possibility that Mr. Howard may purchase Mr. Jennings' entire ownership interest in the parent corporation. Even though there is no evidence of his misconduct, an improper taint is present while Mr. Jennings has any connection with NCACA.

As an absent owner of Henderson Education, Inc, James Howard visited the school no more than a couple times a year, but received frequent site reports which included basic enrollment and graduation statistics. None of his contacts with the school or its staff suggest in any way that he was, or should have been, aware of Mrs. Jennings' attendance figure improprieties. Therefore, there is an absence of taint on Mr. Howard as there is on her husband. With regard to other employees of the school, only Elaine Wright was accused of falsifying student time cards, and this existed because she was allegedly observed by several students who, in turn, complained to Ms. Goransen. When asked, Ms. Wright denied engaging in any such misconduct and there is no evidence to refute her denial. Of all members of the staff, there is proof of only Mrs. Jennings falsifying the time cards, and only an inference that Mr. Jennings knew, or should have known, about this misconduct.

After Mr. Bogart verified the findings of the program reviewers, he next evaluated the methods by which NCACA had historically maintained its attendance data and he made some recommendations as to how this could be improved. Apparently the attendance data collection methods utilized by NCACA do not differ much from the methods used by other clock hour schools. However, he offered suggestions to tighten the controls of the procedures, such as placing preprinted names and dates on attendance cards, and going to the classroom and retrieving cards of students who were absent during the required theory class. The school has implemented these procedures, and they will assist in preventing students or staff members from fraudulently adding additional hours for the students. However, there is no method available to preclude a school administrator from falsifying additional hours of attendance. SFAP must always rely on the administrator's honesty and integrity, and for events such as those which occurred here, relying on someone to observe and report any unauthorized record-keeping. There is no known superior attendance system to substitute for the system now in place at NCACA. The controls exercised by the State Board, the professed integrity expressed by the owners, the additional administrative controls recently implemented by the school, and the general knowledge by instructors and administrators that the future of the school relies on strict adherence to the attendance rules all combine to create an environment that lends credence to the integrity of NCACA's current attendance record system and compliance with its fiduciary responsibilities to the Title IV program.

The final issue to address is whether the purposes and needs of the Title IV program demand that NCACA's eligibility be terminated and it be fined. My answer is that NCACA's Title IV eligibility should not be terminated, but that it should be suspended for one year, beginning with the date of the emergency action and that it should be fined \$45,000 for its falsification of records. The school serves an educational need in the Asheville area, although it clearly is not the only cosmetology school in that region. The culprit has been dismissed as director, Mr. Jennings' association with the school has been severely limited, and it is nearing the point where his financial interest in the school will be terminated. The school has a new director who is capable and expresses confidence in the school's ability to restore its previously good reputation through hard work and the implementation of attendance gathering procedures. NCACA has done everything in its power to eradicate the persons and procedures which resulted in its current difficulty. For these reasons, I find that the emergency action should be replaced by a twelve month suspension of NCACA's Title IV eligibility, which will give it an opportunity to fully develop procedures which will allow it to responsibly administer the Title IV programs. The suspension will simultaneously serve as a deterrent to it and other Title IV participants by reemphasizing that critical attention must be given to their fiscal and administrative responsibilities. Additionally,

although SFAP asked that a fine of \$25,000 be imposed for each of the nine fraudulent student files, I believe a fine of \$5,000 for each of the files will adequately serve the purpose. This will place a definite burden on the school which may well be more than it can endure and still remain functioning for the duration of the suspension. However, it is a punishment that serves the offense.

ORDER

On the basis of the foregoing, it is hereby ORDERED that the North Carolina Academy of Cosmetic Art be suspended from participating in all Title IV programs for a period of 12 months beginning on August 20, 1998, and that it be fined \$45,000.

Judge Richard F. O'Hair

Dated: November 24, 1998

SERVICE

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

Ronald L. Holt, Esq.
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*Footnote: 1 * Later, during his testimony, Mr. Jennings explained that the reason he did not rely on the Hour Book at those times was not because it was erroneous, but that it was not current because his wife was frequently two and one-half to three weeks behind in her annotations of it.*
