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

In the Matter of

CLIMATE CONTROL INSTITUTE,

Respondent.

Docket No. 02-4-SA

Student Financial
Assistance Proceeding
ACN: ARB-0200009

Appearances: Lee Thompson, Esq., Wichita, Kansas, for Climate Control Institute.

Steven Z. Finley, Esq., Office of the General Counsel, United States Department of Education, Washington, D.C., for Federal Student Aid.

Before: Richard F. O'Hair, Administrative Judge

DECISION

The Respondent in this proceeding, Climate Control Institute (CCI), operated two trade schools, one in Wichita, Kansas, and the other in Memphis, Tennessee, and both schools participated in the federal student aid programs authorized under Title IV of the Higher Education Act of 1965 (Title IV, HEA), as amended. 20 U.S.C. §§ 1070 *et seq.* and 42U.S.C. §§ 2751 *et seq.* These programs are administered by the Office of Federal Student Aid (FSA) (formerly designated the Office of Student Financial Assistance Programs (SFAP)), U.S. Department of Education (ED). CCI appealed two of the three findings in FSA's Final Audit Determination dated October 30, 2001. CCI did not appeal the assessment of $37 contained in Finding One, arising from five unresolved FSA compliance audits, therefore, this amount will be included in the final award of this decision. Finding Two addresses CCI's failure to perform a close out audit and Finding Three addresses CCI's failure to make refunds to FSA for students who withdrew prior to completing their field of study. For all three findings, FSA demands the return of $774,167.

CCI's financial/administration problems became public in 1998. In February 1998, FSA conducted a program review of CCI's compliance with Title IV regulations and also re-examined its five prior compliance audits covering the period July 1, 1993, to December 31, 1997, which were all considered unresolved. At about the same time, CCI began receiving its Title IV funds by means of the reimbursement method, a method utilized by ED when there are questions about the integrity of the operation of an institution. In September 1998, the Nebraska Student Loan Program (NSLP), a

student loan guaranty agency, initiated an administrative action against CCI for failing to make timely reimbursements to NSLP for students withdrawing from school prior to completing their training. This action was vacated when CCI voluntarily terminated its instructional operations on November 2, 1998, and entered into a "teach-out agreement" with Vatterott College, Inc. Under this agreement, the latter agreed to assume all teaching responsibilities for currently enrolled CCI students. This authorized Vatterott to receive payment for all student financial assistance due to those students. On October 20, 1998, federal enforcement agents, representing the ED Office of Inspector General (OIG), executed a search warrant and seized all of CCI's business and student aid records. This was conducted pursuant to a criminal investigation into CCI's owner's failure to pay refunds to ED.

Following CCI's execution of its "teach-out agreement," FSA notified CCI of its responsibility under its Title IV Program Participation Agreement to submit a close out audit performed by an independent auditor for the period January 1, 1998, through November 1, 1998. This audit was not filed and, in Finding Two of the Final Audit Determination, FSA demands the return of $485,499 in Title IV funds disbursed during that period. CCI raises the defense of impossibility for its failure to submit the close out audit, explaining that it was impossible for its auditor to prepare this audit because it was not given access to all of its business and student records. CCI maintains that at all relevant times the records remained in the hands of the ED Office of Inspector General, which served as a custodian for the U.S. Department of Justice (DOJ) which was pursuing the criminal prosecution of CCI's owner. CCI argues that despite repeatedly contacting OIG and the Office of the U.S. Attorney in Wichita, Kansas, asking for an opportunity to copy or obtain copies of the necessary records it was repeatedly denied access. Additionally, CCI complains that its records were being held at a number of geographic locations, further complicating CCI's efforts to view and copy them. During the middle of 1999, CCI's attorney made repeated oral and written requests to DOJ on behalf of the school to obtain permission to be given access to the records. After conflicts of the business schedules of CCI's owner and the custodian of the records were resolved, DOJ reported to CCI's counsel on October 1, 1999, that the documents were going to be retained until they were ordered by court to return them, CCI's owner entered a plea agreement, or CCI's owner was convicted. This letter further explained that DOJ would authorize CCI's owner to have access to these documents to copy them, but that the copying would be at the owner's expense.

CCI's second line of defense to the demand for a close out audit is that such an audit was not necessary because technically the school did not close on November 2, 1998, it merely transferred all operations to another institution, Vatterott College, Inc., via the "teach-out agreement." Its third position is that an audit was not necessary because it was placed on the reimbursement basis in February 1998 and, thus, all disbursements were approved by ED from that date forward.

Countering CCI's complaint that following their seizure in October 1998 its records were not available to be provided to an auditor, FSA submitted an affidavit from one of its program review specialists who was familiar with the records' availability during the time in question. The specialist stated he was unaware of any instance in which OIG denied CCI access to its records. In fact, he continued, every time CCI's representatives asked for access to the records they were allowed to review them and make any necessary copies, free of charge, despite DOJ's position that CCI could not have free copies of the records. The last date on which a CCI representative requested and was given access to the records was December 10, 2001; the records were returned to CCI in late March or early April 2002. The specialist said CCI has not submitted an audit for the time in question and has not requested additional time in which to complete an audit.

One of the contractual obligations CCI accepted when it signed the Program Participation Agreement and began participating in the federal student aid programs was to act as a fiduciary in the administration of the Title IV programs. 34 C.F.R. § 668.82. This agreement requires that it demonstrate that all questioned expenditures were proper and that it complied with program requirements. 34 C.F.R. § 668.116(d). The accepted method for CCI to demonstrate that all of its expenditures were proper for the ten-month period beginning January 1, 1998, is to submit a close out audit. There is ample case support for the proposition that, in the absence of a close out audit or other relevant and reliable evidence of a proper disbursement of Title IV funds, the institution is liable to repay all funds for the period of time from its last submitted audit. *In re Stenotopia Business School*, Docket No. 01-26-SP, U.S. Dep't of Educ. (July 31, 2002); *In re Southern College and Southeastern* Academy, Docket Nos. 01-42-SA and 01-42-SP, U.S. Dep't of Educ. (April 29, 2002); *In re Midland Career Institute*, Docket Nos. 96-140-SP and 96-141-SP, U.S. Dep't of Educ. (July 30, 1998); *In re Magic Touch Beauty Institute*, Docket No. 97-161-SP, U.S. Dep't of Educ. (July 2, 1998).

CCI has claimed it was impossible for it to produce a close out audit for its last 10 months as a participant in the Title IV programs because OIG retained all of the relevant records at two different locations and would not give CCI copies of these records. FSA satisfactorily has negated this complaint by showing that it acceded to CCI's request to view and make free copies of these records whenever such requests were made. Additionally, these records were returned to CCI in March or early April 2002. It should be noted that in an October 21, 2001, letter from CCI's counsel to FSA, counsel explained that CCI's owner "has pled guilty to a violation of federal law relating to failure to pay refunds to DOE." Apparently after this date, CCI did not avail itself of the opportunity to view and make a copy of these records for its auditor, and no audit was filed. Albeit several years late, CCI could have secured the services of an auditor subsequent to the return of the records and submitted an audit which might have eliminated the need for this hearing.

Assuming CCI was correct in its position that OIG refused to give it or its accountant reasonable access to all necessary records, this would not have served as a defense to the instant proceeding. *See In re Magic Touch Beauty Institute, supra.* The requirement for submission of a close out appears to be absolute when an institution ceases operation. Even though CCI was placed on the reimbursement basis in February 1998, and from that date forward had to substantiate its claims for Title IV funds, this is not a substitute for the audit. Furthermore, CCI was not on the reimbursement basis for the entire 10 month period addressed here, and there is some question as to whether all necessary reimbursement requests were submitted to FSA to support its claim for Title IV funds during that period of time. Additionally, when Vatterott College entered the teach-out agreement, for all intents and purposes, CCI ceased participation in the Title IV programs and this triggered the requirement for a close-out audit.

CCI has not satisfied its burden of proof that all expenditures of federal funds during the period of January 1 to November 2, 1998 were proper. 34 C.F.R. § 116(d). One may argue that during its last ten months of operation, CCI was providing a satisfactory education to its students. One may further argue that if they ultimately graduated following the completion of their studies with Vatterott College, this should satisfy FSA's concern that the federal funds were appropriately expended. If such were true, then it would seem to be an unjust enrichment to FSA if it were to recover all funds disbursed when, in fact, they were expended pursuant to regulatory standards. In this case, however, such a determination can be made only from objective facts and an audit covering that period of time is the only reasonable alternative for acquiring those objective facts. Accordingly, in the absence of the submission of a close out audit, CCI must reimburse FSA $485,499 for Title IV funds it received during the first ten months of 1998.

The third finding in the Final Audit Determination addresses a total file review of all students who withdrew from CCI prior to completing their program of study between June 1994 and November 2, 1998. The reviewers, after conducting a student by student calculation of student payments and withdrawals, concluded that CCI owed ED refunds of $366,676. Recognizing there was some duplication by virtue of the demand for all funds disbursed during 1998, the reviewers recomputed the amount of unpaid refunds originating during the period June 1994 and December 31, 1997. This recalculation resulted in an amount due of $288,631.

CCI objects to this liability assessment and asserts that it is based upon calculations of funds which were never disbursed to the students, and that ED cannot identify which students withdrew and necessitated the current payment of refunds. It also argues that this assessment is contrary to the guidance found in 34 C.F.R. §§ 668.23(g)(2)(ii) and 668.95(c) which authorize the Secretary of the U.S. Department of Education to use an administrative offset to collect the funds owed in these proceedings. CCI maintains that ED owes it $187,741.14 for previously submitted requests for reimbursements and that ED should deduct its current assessment from that amount.

As mentioned previously, CCI bears the burden of proving that its federal funds were properly disbursed, and this includes proving it made the proper payment of refunds to ED for students who withdrew prior to completing their course of study. 34 C.F.R. § 668.116(d). In the face of student specific compilations of student refunds, CCI makes the general objection that the computations are incorrect because they are based upon improper assumptions; CCI, however, has not performed a full file review to counter FSA's calculation and demand. Additionally, it should be noted that CCI's owner pleaded guilty to "a violation of federal law relating to failure to pay refunds to DOE." In connection with that guilty plea, the owner is under a restitution order to pay ED $120,000. In the absence of any submission by CCI to contradict the conclusions of the OIG file review, I must conclude that CCI has failed to meet its burden of persuading

me that the Final Audit Determination is incorrect. CCI owes ED refunds in the amount of $288,631 as demanded in the Final Audit Determination.

ORDER

On the basis of the foregoing, it is hereby ORDERED that Climate Control Institute pay to the U.S. Department of Education the sum of $774,167.

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Judge Richard F. O'Hair

Dated: November 14, 2002

SERVICE

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

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