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

In the Matter of

INSTITUTO de ESTÉTICA y BELLEZA MARUGIE,

Respondent.

Docket No. 03-21-SP

Federal Student Aid Proceeding

PRCN: 2001-3-02-18504

Appearances: J. Andrew Usera, Esq., Vienna, Virginia, for Instituto de Estética y Belleza Marugie.

Denise Morelli, Esq., Office of the General Counsel, United States Department of Education, Washington, D.C., for Office of Federal Student Aid.

Before: Richard F. O'Hair, Administrative Judge

DECISION

The Respondent in this proceeding, Instituto de Estética y Belleza Marugie (Instituto), was a participant in the Federal Pell Grant and Federal Family Education Loan programs, authorized under Title IV of the Higher Education Act of 1965 (Title IV), as amended. 20 U.S.C. §1070 *et seq.* and 42 U.S.C. §2751 *et seq.* The Office of Federal Student Aid (FSA), U.S. Department of Education (Department), administers these programs. In May 2001, a team of FSA's institutional review specialists conducted an on-site program review of Instituto's Title IV program compliance for the 1998-1999, 1999-2000, and 2000-2001 award years. The team examined a sample of student files for each of the award years.[1] After its analysis of the samples, the team concluded that Instituto "routinely falsified student documentation in order to obtain, and retain, Title IV funds to which it was not entitled." As a result, FSA imposed an emergency action, and initiated termination and fine actions against Instituto. The parties subsequently entered into a settlement agreement that provided for the termination of Instituto's participation in the Title IV programs. Recognizing its right to demand the repayment of Title

[1] There were 40 students in the sample for 1998-1999, 109 students for 1999-2000, and 71 students for 2000-2001.

IV funds which were disbursed by an institution in violation of its fiduciary responsibilities, FSA's attempt to recoup improperly disbursed Title IV funds from Instituto, as documented in the program review, began with a Final Program Review Determination letter (FPRD). This letter, dated January 13, 2003, demands the return of $1,870,933. Instituto appealed this assessment and has submitted briefs and exhibits in support of its position. Under 34 C.F.R. § 668.116(d), Instituto bears the burden in this proceeding of proving that the questioned disbursements of Title IV funds entrusted to it were proper and that it complied with program requirements.

The FPRD describes four findings of violations of regulatory provisions that support FSA's monetary demand. Finding #1: Instituto disregarded the program's student eligibility requirements found in 34 C.F.R. § 668.32 by using falsified Ability to Benefit (ATB) tests to demonstrate students' Title IV eligibility. Finding #2: Instituto illegally retained Title IV funds by failing to properly calculate and pay refunds for students who withdrew prior to completing their programs of study. Finding #3: Instituto utilized falsified, inflated attendance records resulting in Pell awards to students who had not completed the minimum number of class hours. Finding #4: Instituto used falsified attendance records to obtain and illegally disburse second or subsequent Pell awards.

FSA used two different methods for calculating Instituto's liabilities. For all funds improperly disbursed to the ATB students (Finding #1), FSA was able to specifically identify those students and the amounts of student aid disbursed on their behalf. As a consequence, FSA demanded the return of all student aid given to those students ($1,093,451). The liability computation became more complicated for the other three findings. Because of Instituto's unreliable student files, FSA could not easily ascertain the exact amount of improper disbursements for each of these findings. Another complicating factor was that some of the student files disclosing those three findings were also those belonging to ATB students. In an attempt not to duplicate or overcharge Instituto by assessing liabilities against the same student's account for both ATB violations (Finding #1), as well as Finding #2, #3, and #4 violations, FSA devised an error rate projection calculation for determining the appropriate liabilities for the latter three findings for each award year for non-ATB students. This will be discussed in detail below.

Instituto does not challenge FSA's four findings of fault as outlined in the FPRD. Additionally, it does not challenge the demand for reimbursement of all Pell Grants awarded to ATB students who were granted Title IV eligibility based upon what FSA has characterized as falsified ATB tests. The focus of this appeal, however, is to challenge the means by which FSA determined a liability assessment of $777,482 for Findings #2, #3, and #4 for non-ATB students. Instituto maintains that the exclusion of the program violations for the ATB students using FSA's formula improperly skews the computations to Instituto's detriment because the bulk of the violations for Findings #2, #3, and #4 were found in ATB student files. The threshold question in this proceeding, as posited by Instituto, is whether FSA applied a standard that is statistically and legally justifiable in the calculation of the liabilities under those three findings.[2]

FSA's error rate projection looked at the Finding #2, #3, and #4 violations in each sample and projected the error rate to the whole universe of students. This consisted of a two-step process: an Error Rate Determination and the Projection Calculation. The FPRD set out instructions for these as follows:

FSA Error Rate Determination:

a. The liabilities per student in the program review sample were identified for the refund, Pell over award, and ineligible disbursement findings (Findings #2, #3, and #4) for each year. [3]

b. The total Pell Grant funds received for all students in the program review sample who *did not* also fall into the ATB/basis of admission finding were identified.

c. The total student liabilities in the sample were divided by the total Pell received by the students in this sample to calculate the percentage of Pell funds reviewed that the Department was able to determine were misspent. This is the error rate for the *sample* for each award year.

FSA Projection Calculation:

a. The total Pell funds disbursed to the institution for each award year were identified.

b. The Pell funds received by the students in the ATB/basis of admission findings were subtracted from the total Pell in order to obtain the universe of Pell funds applicable to the remaining findings. The ATB funds were excluded from the "projection universe" because the Department has already assessed liabilities for the full universe of students it has identified as relevant to this finding.

c. The error rate, as calculated above, for each award year was multiplied by the Pell funds received for the students in the "projection universe" to determine the projected liabilities for the ineligible disbursement, refund, and Pell over award findings.[4]

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[2] Instituto filed an Initial Brief and a Response brief. In its initial brief, Instituto argued that the liabilities identified in its "FY 2001 SFA Audit" had already been deducted from funds due Instituto and were now being charged as liabilities in this FPRD. This issue was not addressed by FSA in its brief, nor was it mentioned again in Instituto's Response Brief. Therefore, the tribunal assumes this issue was resolved by the parties and, therefore, is not addressed herein.

[3] Although not stated, it is clear from the end result that this figure includes liabilities attributable only to non-ATB students.

[4] *See* Resp. Ex. 1, FPRD.

In its Initial Brief, Instituto criticizes FSA's calculation and asserts that the error rate projections should be computed individually for each finding for each award year and it set out a formula for computing these projections. This formula naturally required that the regulatory violations in the total universe must be segregated according to each finding. In its brief, FSA objected that since the veracity of Instituto's student records was so questionable, Instituto's suggested formula would result in amounts in which FSA would have no confidence. Therefore, in its Response Brief, Instituto proposed a more streamlined method of calculating the error rate projection. This method involved computing a single error rate for each award year using a slightly modified version of FSA's method. For this alternative calculation, Instituto's auditors broke the process into five steps.

Instituto's Error Rate Projection:

Step 1. Determine the error rate for the Findings #2, #3, and #4 for <u>all</u> students (including ATB students) in the sample for an award year by dividing the liability attributable to those findings by the amount of Title IV funds received by <u>all</u> students in the sample.

Step 2. Multiply this error rate by the total amount of Title IV funds received by <u>all</u> students in the universe, thus providing the projected liability for the universe for that year.

Step 3. Determine the liability for only the non-ATB students in the sample.

Step 4. Divide the total liability in the sample by the non-ATB student liability. This provides the percentage of the total liability in the sample represented by the non-ATB student liability.

Step 5. Multiply this percentage against the projected liability for the universe computed in Step 2.[5]

I have concluded that Instituto's formula is a bit more complicated than FSA's, but provides a much more accurate computation. To illustrate this, I have computed the liabilities assessed for Findings #2, #3, and #4 using both FSA's and Instituto's formulae for the 1998-1999 award year.

<u>FSA's Error Rate Determination is as follows:</u>

Step 1. Non-ATB liabilities in the sample.	$2,866
Step 2. Pell Grants for non-ATB students in the sample.	$19,694

[5] *See* Resp. Ex. 11, letter and attachments from Instituto's accountant.

Step 3. Error rate in the sample. ($2,866/$19,694)	15%

FSA's Projection Calculation:

Step 1. Total Pell Grants for all students.	$2,057,163
Step 2. Total Pell Grants less Pell Grants for ATB students gives new universe of non-ATB students.	$1,630,877
Step 3. Multiply error rate by the new the universe and this provides the liability for that year. (15% X $1,630,877)	$244,632

Instituto's Error Rate Projection Calculation:

Step 1. Find the error rate for all students in the sample for Findings #2, #3, and #4. ($5,862/$63,612)	9.2%
Step 2. Multiply error rate by the total universe of Pell Grants received. (9.2% X $2,057,163)	$189,259
Step 3. Determine liability for non-ATB students in the sample by deducting liability attributable to ATB students. ($5,862 less $2,996)	$2,866
Step 4. Find ratio of non-ATB liability to total liability in the sample. ($2,866/5,862)	48.9%
Step 5. Multiply error rate by the projected universe liability and this provides the liability for the year. (48.9% X $189,259)	$92,548

I concur with FSA's objection to Instituto's first proposal that a liability should be computed separately for each finding because of the impossibility of determining the total universes for each finding. Instituto eliminated this weakness in its Response Brief, however, by adopting a method whereby Findings #2, #3, and #4 for each award year are combined for the computations. Although the formulae presented by both parties appear to be reasonable, I find that Instituto has made a compelling argument that FSA's formula for calculating the error rate projection is flawed. FSA's method employs a wholesale removal of ATB student liabilities from the sample and the total universe before the error rates are computed. This is bothersome to me because, after all, this projection is just a calculated estimate at what amount of Title IV funds the school must reimburse FSA because they were given to students in violation of the regulations. This involves the simple step of looking at the percent of misspent funds in the sample and applying that same percentage to the universe of students. With the removal of ATB students from the sample and universe, FSA has created a whole new artificial sample and universe that are one step removed from, and no longer representative of, the originals.

My lack of confidence was further heightened when I looked at Steps 1 and 2 of Instituto's formula. As I understand the computation to that point, if this case involved only three findings (Findings #2, #3, and #4) and an error rate projection method were utilized, the school would be assessed a liability of $189,259 for this award year. This figure is much less than the $244,632 FSA assessed and it is determined before there is any consideration of removing ATB students from the formula, a step that is supposed to be for the benefit of Instituto. Therefore, after Instituto's error rate projection is applied to the entire universe of students in Step 2, it only makes sense that the liability should be further reduced by the ratio of non-ATB student liability in the sample to the total liability in the sample to preclude FSA from recovering Title IV funds twice for the same ATB students. Instituto's formula results in error rate projections of $92,548 for 1998-1999, $44,604 for 1999-2000, and $220,549 for 2000-2001.

I find Instituto has carried its burden of persuasion in this proceeding with its submission of the revised formula in its Response Brief and I agree with the methodology it employed for computing the liabilities. FSA objected to Instituto's request in its Initial Brief that liabilities be computed separately for each finding because its student data, to include the amounts of Pell awards received, was not credible. Only a full file review would address this deficiency and that has already been ruled out by FSA, and I agree with their lack of confidence in the veracity of Instituto's student files. Other than that, FSA did not rebut the revised error rate projection calculation proposed in Instituto's Response Brief. After analyzing the two different approaches, I have concluded that the error rate projection calculations submitted by Instituto best represent the projection of its liabilities from the samples of students to the universes of students.

At some time during 2001, FSA placed Instituto on a reimbursement method for transferring Title IV aid to it. Instituto has identified $1,319,895 in unpaid reimbursements and asks that the liabilities identified in this proceeding be reduced by the amount of its unpaid reimbursement liabilities from FSA. It is well recognized that the tribunal has jurisdiction over only the supportability of the FPRD currently before it. Any issue addressing FSA's liability to the institution for reimbursement payments is outside the scope of this proceeding. *See New Concept Beauty Academy v. U.S. Department of Education et al.,* No. 97-CV-7939, E.D. Pa (October 29, 1998); *In the Matter of Modern Trend Beauty School*, Dkt. No. 98-109-SP, U.S. Dep't of Educ. (October 11, 2001). Accordingly, Instituto's request that it be credited in this proceeding for unpaid reimbursements from FSA is denied.

ORDER

On the basis of the foregoing, it is hereby ORDERED that Instituto de Estética y Belleza Marugie pay the United States Department of Education $1,451,152.

Judge Richard F. O'Hair

Dated: March 1, 2004

SERVICE

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

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