
**AUDIT OF
COLLEGIATE SYSTEMS, INC.
COMPLIANCE WITH THE
85 PERCENT RULE**

FINAL AUDIT REPORT



Audit Control Number 06-80012

August 1999

Our mission is to promote the efficient
and effective use of taxpayer dollars
in support of American education



U.S Department of Education
Office of Inspector General
Dallas, Texas

NOTICE

Statements that management practices need improvement, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken will be made by appropriate Department of Education officials. This report may be released to members of the press and general public under the Freedom of Information Act.

EXECUTIVE SUMMARY

Three of the four proprietary schools owned by Collegiate Systems, Inc. (Collegiate) did not receive at least 15 percent of their revenue from non-Title IV sources during the fiscal year ending December 31, 1997. As a result, the schools did not qualify as eligible institutions and were ineligible to participate in Title IV programs as of December 31, 1997. The three ineligible schools received \$396,490 in Federal Pell Grants (Pell) and \$850,345 in Federal Family Education Loans (FFELP) during the year ending December 31, 1998. The three schools and our calculated percentages of Title IV revenue are:

- ❖ Metropolitan College of Legal Studies-Tulsa, Oklahoma - 85.477%
- ❖ Metropolitan College-Oklahoma City, Oklahoma - 85.277%
- ❖ Metropolitan College of Court Reporting-Albuquerque, New Mexico - 86.920%

Under the Higher Education Act, proprietary institutions must derive at least 15 percent of their revenues from non-Title IV sources to participate in Title IV programs. Conversely, schools may not derive more than 85 percent of total revenue from Title IV resources. This institutional eligibility requirement is commonly referred to as the 85 Percent Rule. Collegiate reported that its four proprietary schools met the requirements of the 85 Percent Rule in the **A**Notes to Financial Statements[®] of its annual financial statement audit report for fiscal year 1997. In the 1997 calculations, Collegiate (1) improperly included revenue from the sale of equipment and supplies that was not part of the normal tuition and fees, and (2) failed to consider cash payments made by students when calculating the amount of Title IV funds to disburse to students for living expenses. In addition, Collegiate made mathematical errors in its 1997 calculation.

We recommend that the Chief Operating Officer for the Office of Student Financial Assistance Programs:

1. take action to terminate the three schools that did not meet the requirements of the 85 Percent Rule unless Collegiate can demonstrate that the schools each met the requirement for the year ended December 31, 1998; and
2. require Collegiate to return \$396,490 to the Department for Pell funds received and return \$850,345 to the lenders for FFELP loans received by the schools. The amounts represent Title IV funds received by the three schools during the period January 1, 1998 through December 31, 1998.

Collegiate Systems Inc did not agree with our findings and recommendations. A copy of their full written response is attached to this report. Exhibits that were attached to the written response are available with written request.

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June 17, 1999

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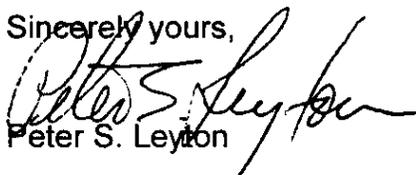
Re: Response of Wyandotte Collegiate Systems, Inc. to OIG Draft Audit, CAN 06-80012

Dear Mr. Thaens:

Attached is Wyandotte Collegiate Systems, Inc.'s response to the above referenced Draft Audit. Per our agreement, I am transmitting to you the response without exhibits via facsimile and the original with exhibits via overnight delivery.

Thank you for your courtesies in this regard. Please contact me should you have any questions in this regard.

Sincerely yours,



Peter S. Leyton

c: David L. Stephenson

**WYANDOTTE COLLEGIATE SYSTEMS, INC.'S
RESPONSE TO THE OFFICE OF INSPECTOR
GENERAL'S DRAFT AUDIT REPORT
ACN 06-80012**

Set 1 of 5

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EXHIBIT LIST

1. OIG Draft Audit
2. Collegiate Systems, Inc. d/b/a Metropolitan Colleges Of Legal Studies And Court Reporting Financial Statements and Additional Information December 31, 1997 And 1996
3. Department of Education Eligibility And Certification Approval Reports
4. Declaration of Rodney Crocker
5. February 10, 1994 Federal Register
6. April 29, 1994 Federal Register
7. January 7, 1999 "Policy Interpretation And Guidance"
8. November 3, 1999 Emergency Action Letter from U.S. Department Of Education to Commonwealth International University
9. Metropolitan College of Legal Studies Enrollment Form
10. Estimated Financial Aid Award And Payment Plan
11. 85 Percent Rule Calculations With Books and Equipment Included As Revenue
12. 85 Percent Rule Calculations With Books and Equipment Included As Revenue, Less Credit Balance
13. 85 Percent Rule Calculations Excluding Books, Equipment and Credit Balances As Revenue But including Cash Payment

**WYANDOTTE COLLEGIATE SYSTEMS, INC.'S
RESPONSE TO THE OFFICE OF INSPECTOR
GENERAL'S DRAFT AUDIT REPORT
ACN 06-80012**

**I.
PRELIMINARY STATEMENT**

On April 16, 1999, the Office of Inspector General ("OIG") issued a draft audit report to Collegiate Systems, Inc. (now known as Wyandotte Collegiate Systems, Inc. "Collegiate" or "WCSI"), Audit Control Number 06-80012 ("Draft Audit", *Exhibit 1*). The Draft Audit focused solely upon Collegiate's compliance with what is commonly referred to as the 85 Percent Rule.¹

The Draft Audit concluded that the percentage of non-Title IV revenue in the fiscal year ending December 31, 1997 at three of the four proprietary colleges then owned by Collegiate Systems, Inc. did not achieve the minimum non-Title IV revenue threshold of 15 percent.² In contrast to the Draft Audit conclusions, Collegiate reported that 84.7% of Tulsa, 84.56% of Oklahoma City and 84.77% of Albuquerque's revenue was from Title IV for fiscal year 1997. *Exhibit 1 at 2 and Exhibit 2 at footnote 9.*

As can be seen, the spread between Collegiate's reported percentages and those of the Draft Audit are, for Tulsa and Oklahoma City, very slight at under 1 percent and modestly different for Albuquerque at about 2 percent. The potential affect is, however, of staggering proportions. The differences caused by the OIG calculations are the result of the OIG's exclusion of all revenue from the sale of equipment and supplies from both the numerator and denominator and the addition of student cash payments for "equipment and/or living expenses" to the numerator. *Exhibit 1 at 4-5.*

The OIG recommends that the Office of Student Financial Assistance ("OSFA") take an action to terminate the three Colleges' participation in the Title IV programs unless they can demonstrate that they met the 85 Percent Rule (now 90 Percent Rule) for fiscal year 1998. The OIG further recommends that OSFA require Collegiate to return about \$1.25 million in combined Title IV grants

¹ Under the 85 Percent Rule, at least 15 percent of a proprietary school's revenue had to be derived from non-Title IV sources. 20 U.S.C. § 1088(b)(6)(section 481(b)(6) of the HEA) and 34 C.F.R. § 600.5(a)(8). On October 7, 1998, the HEA was reauthorized as part of which this provision was amended to require that at least 10 percent of a proprietary school's revenue has to be derived from non-Title IV sources. Section 102 of the Higher Education Amendments of 1998. The Department has not issued any formal guidance with respect to the effective date of this provision, however, it has informally advised the affected community that the 10 percent rule is effective with respect to any fiscal year ending on or after October 7, 1998.

² The three Colleges are Metropolitan College of Legal Studies in Tulsa, OK, Metropolitan College in Oklahoma City, OK, and Metropolitan College of Court Reporting in Albuquerque, NM. Their Title IV revenue percentages for FY 1997, according to the Draft Audit, are 85.477%, 85.277% and 86.920%, respectively. *Exhibit 1 at 2.*

and loans disbursed during fiscal year 1998, the year after the three schools allegedly lost their eligibility. *Exhibit 1 at 1.*

Collegiate submits that the OIG conclusion that equipment is not an institutional charge is plainly wrong and further submits that its calculation of Title IV and non-Title IV revenue was correct. In fact, Collegiate should have included reductions to revenue in the numerator and denominator for credit balances created by receipt of Title IV funds that existed on December 31, 1997.³ *Exhibit 4 at ¶ 16.* Collegiate has recalculated its 85/15 percentages with this new information in this response. The result is even lower Title IV revenue percentages than originally reported. *Exhibit 12.* The OIG argument to add back of student cash payments for living expenses is contrary to the intent of the 85 Percent Rule. Further, the OIG has failed to specify the breakdown of the applicable figures for the three schools.

For these and other reasons advanced below, Collegiate submits that its interpretations of law and fact were accurate and made in good faith and that the OIG conclusions and recommendations are unfounded and inappropriate.

II. BACKGROUND

Metropolitan Colleges is the principal trade name of the colleges owned by WCSI. The colleges are participating institutions of higher education located in Tulsa and Oklahoma City, Oklahoma, Albuquerque, New Mexico, Independence, Missouri, and Phoenix, Arizona. WCSI also owns the Institute of Legal & Medical Professions in Melbourne, Florida. *Exhibit 4.*

The Wyandotte Tribe of Oklahoma, a federally chartered tribal entity, acquired Metropolitan Colleges at the end of October 1998. The institutions offer bachelor and associate degree programs as well as non-degree vocational programs designed to prepare individuals for gainful employment in recognized occupations in court reporting, legal and medical transcription. *Exhibit 3 (ECARs) & Exhibit 4 (Declaration of Rodney Crocker).*

The College in Tulsa was founded in 1979 as Tulsa School of Court Reporting. The School became quite successful and, in 1982, the School became a full-time institution and a leading Court Reporting school in Eastern Oklahoma. In 1990, Collegiate Systems, Inc acquired the School. The B.A.S. in Court Reporting offered at Metropolitan Colleges in Albuquerque, Tulsa, Oklahoma City, Kansas City and Phoenix are the only baccalaureate programs in Court Reporting that are in the western part of the United States. In 1998, the College added a Medical Transcription program.

The College in Oklahoma City was founded in 1982 as Zigler School of

³ Documentation to support the credit balance figures will be separately provided.

Court Reporting, by Tom Zigler, a practicing Court Reporter. In 1991, the school was acquired by CSI. Court Reporting educators, Loretta and Steve Clark founded the College in Albuquerque in 1980 as New Mexico School of Court Reporting. In 1992, the School was acquired by CSI.

There are presently about 198 students enrolled in programs at all three affected schools combined and about 46 people employed as faculty and staff including the management. *Exhibit 4.*

III. THE 85 PERCENT RULE

The 85 Percent Rule was enacted in 1992. It provided that proprietary institutions of higher education must derive "at least 15 percent" of their revenues from non-Title IV sources. Section 481(b)(6) of the HEA.

According to the Secretary, the principal purpose of the law "... is to require proprietary institutions to attract students based on the quality of their programs, not solely because the institutions offer Federal student financial assistance. Thus, under the statute, these institutions must attract students who will pay for their programs with funds other than Title IV, HEA program funds." *Exhibit 5, 59 Fed. Reg. 6446, 6448 (Feb. 10, 1994)(emphasis added).*

Final regulations were promulgated on April 29, 1994. *Exhibit 6.* Congress, however, delayed their effective date to July 1, 1995. Pub.L.103-333; see 34 C.F.R. § 600.5(a)(8). The regulations require all proprietary institutions to disclose the percentage of their revenue derived from Title IV, HEA programs, as defined at section 600.5(d), in a footnote to their annual audited financial statements. 34 C.F.R. § 668.23(d)(4).

The Secretary requires a proprietary institution to determine the percentage of its revenue from Title IV and non-Title IV sources by dividing the amount of Title IV funds the institution used to satisfy tuition, fees and other institutional charges by the sum of revenues generated by the institution from tuition, fees and other institutional charges for students enrolled in eligible programs as defined in 34 CFR § 668.8. See 34 C.F.R. § 600.5(d)(1).

In making these calculations, the Secretary not only encouraged schools to obtain cash payments from students but also made it very clear that revenue generated for tuition, fees and other institutional charges from students enrolled in eligible programs is the quintessential test for counting revenue. The Secretary provided that the amount charged by the institution for books, supplies and equipment is not included in the numerator or denominator unless the amount is included in tuition, fees or other institutional charges. 34 C.F.R. § 600.5(d)(2)(iv). The Secretary did not expound in this section on how to

determine if the amount charged was included in tuition, fees or other institutional charges.

IV.
COLLEGIATE'S CALCULATION OF ITS NON-TITLE IV REVENUE
WAS IN ACCORDANCE WITH LAW AND PROPER

Collegiate calculated the 85 Percent Rule rates in accordance with available regulatory guidance. *Exhibit 4 at ¶ 7*. In particular, Collegiate included revenue from the sale of books, supplies and equipment in the numerator and denominator of the fraction because Collegiate includes these items in tuition, fees and institutional charges. 34 C.F.R. § 600.5(d)(2)(iv). The Draft Audit excludes equipment and supplies but not books from the numerator and denominator of each school's rate calculation. *Exhibit 1 at 4 and Appendix 1-4*. The Draft Audit does not explain why revenue received from the sale of books was not treated in the same manner.⁴

The OIG states that equipment and supplies are excluded from the numerator and denominator because students had the option to purchase equipment and supplies from sources other than the Colleges and because the equipment and supplies were not included as part of the cost of the student's educational contract.⁵ *Id.* While the OIG offers no support for either position, it appears possible that the language in the school's catalogs might have misled the OIG into reaching an erroneous conclusion. The catalogs state as follows:

TEXTBOOK CHARGES

A current list of textbooks and fees are on file in the Registrar's Office. Textbooks are charged when issued and not refundable once issued.

EQUIPMENT CHARGES

Those students taking Court Reporting will be responsible for purchasing a court reporting machine. A new machine will cost from \$950 to \$1,350. Those students taking Medical Transcription will be responsible for purchasing a transcription machine. A new machine will cost \$350 to \$450. Students may purchase a used or re-conditioned machine on their own. New machines are charged when issued and not refundable once issued. The College provides a list of used machines for sale from individuals. The College is not responsible for the condition of such used machines. The College may provide guidance and assistance regarding purchasing a used machine from a private individual, but the College will

⁴ The revenue figures for book sales for FY 1997 were \$26,174 for Tulsa, \$19,163 for Oklahoma City and \$23,744 for Albuquerque. *See Exhibit 4 at ¶ 8*.

⁵ In fact, Collegiate's treatment of books in this respect was no different than its treatment of equipment and supplies. *Exhibit 4*.

not be responsible for returning the used machine to the seller for nonpayment, securing payment from the purchaser, or replacing the machine for any reason.

The determining factor with respect to whether revenue from charges for books, equipment and supplies is included in the numerator and denominator is whether these items were included in the school's charges for tuition, fees or institutional charges. 34 C.F.R. § 600.5(2)(d)(iv).

Students enrolling at Collegiate sign an enrollment agreement. *Exhibit 9 is an example of one from Tulsa.* This enrollment agreement includes estimated costs for attending the College for books and supplies (includes equipment). *Id.* It further reflects that the total due upon entry includes the cost of books and supplies. The tuition supplement form attached to Exhibit 9 also makes it clear that charges are for both textbooks and supplies and that "textbook and equipment charges are due and payable on the first day of the start of that trimester..."

The estimated financial award and payment plan presented to and signed by students also includes equipment and book charges on the list of total charges to be paid for through the package including Title IV funds. *Exhibit 10.* This form reflects both the tuition charge and other charges.

In January 1999, the Department issued a "Policy Interpretation and Guidance" document that specifically addressed the question of "what are institutional charges?" *Exhibit 7.* In point of fact, 34 C.F.R. § 668.22, which the Policy Bulletin interprets, has been relied upon by the Department to establish the opposite position of the OIG in this case.⁶

According to the Department, "other charges are not limited to items that are listed in the enrollment agreement" nor must a charge be assessed to all students to be considered an institutional charge. *Exhibit 7 at 2.* Most importantly, the student must have a "real and reasonable opportunity" to purchase equipment and supplies from someplace other than the school. *Id. at 2-3.*

If an institution does not have a separate charge for equipment and the student has the *option* of purchasing the equipment from more than one source, the institution would not have to include the equipment charge as an institutional charge. This requires demonstrating that an option actually existed. An institution would not be able to demonstrate that a student had a real and reasonable opportunity to purchase his or her required course materials from alternative sources if one of the following is true:

⁶ See e.g. *Exhibit 8, portion of Emergency Action Letter In the Matter of Commonwealth International University.*

The required course materials are not available elsewhere or they are not conveniently available for purchase from another source;

The institution does not make financial aid available to students in time to purchase the required materials from another source before those materials are required for academic purposes;

The institution's practices do not allow or discourage a student from exercising his option; or

The institution cannot document that an option truly exists. *Id.*

Equipment and supplies are listed as costs and charges in the enrollment agreement and attachments. Second, Collegiate requires students to purchase the equipment for the programs of study affected. Generally speaking, therefore, equipment and supplies would be considered institutional charges. *Id. at 5.*

Collegiate's catalogs state that used equipment and supplies may be purchased elsewhere, however, this does not demonstrate that they truly were available elsewhere. More significantly, even if they were, Collegiate did not make financial aid available in time for students to use it to purchase the equipment and Collegiate's routine practice was to credit student's accounts with financial aid and extend lines of credit to students for purchases from the school. *Exhibit 4 at ¶ 12.*

In the instant case, nearly all students obtain their books, equipment and supplies from the Collegiate. *Exhibit 4 at ¶ 15.* In all cases, students need the books, equipment and supplies at the beginning of their programs of study and in most cases, students have to obtain their books, equipment and supplies before they receive any Title IV funds. *Id.* Collegiate's practice as addressed above solves this problem but is clear evidence of why no real and reasonable opportunity to purchase elsewhere exists.

Thus, under the Department's criteria, Collegiate's practices did not afford students a real and reasonable opportunity to purchase their equipment and supplies elsewhere. Therefore, Collegiate's calculations, which included equipment in the numerator and denominator, were proper and the OIG's exclusion of these amounts is contrary to law.

Accordingly, the Colleges original approach was correct. Correcting for math errors noted by the OIG, the 85 Percent analysis for each school as originally calculated is 84.64% for Tulsa, 84.5% for Oklahoma City and 85.08% for Albuquerque. *See Exhibit 11.*⁷

⁷ If the OIG analysis of equipment is correct but there is no add back for student cash payments, then the percentages for Tulsa, Oklahoma City and Albuquerque are all below 85 percent at 84.1%, 83.7% and 84.4%, respectively. If book sales are also removed from revenue because

As noted in Rodney Crocker's Declaration, credit balances were created at the end of FY 1997 as a result of Title IV receipts in excess of tuition, fees and institutional charges. *Exhibit 4 at ¶ 16*. These credit balances should have been deducted from the numerator and denominator of the fractions but were not because there did not appear to be any need to do so. Applying the reduction of the credit balances to the numerator and denominator results in a corrected 85 Percent Rule calculation for Tulsa of 84.1%, for Oklahoma City of 83.4% and for Albuquerque of 84.8%. *Exhibit 12*. This results in all three locations being below 85% in Title IV revenue for FY 1997. If equipment and supplies are removed from the fraction as the OIG argues but books are added to this amount, and credit balances are subtracted from the fraction but the OIG cash payments are added back, the resulting percentages are 84% for Tulsa, 83.5% for Oklahoma City and 85.7% for Albuquerque. *Exhibit 13*.

In sum, if equipment is treated like books and the revenue from these charges is treated as institutional charges and included in the fraction and no student cash payments are added back as argued below, all three schools are below 85 percent for FY 1997. If the OIG approach is taken including use of the student cash payment figures identified in the Draft Audit but book sales are added to the equipment deduction from revenue since there is no valid basis to treat book revenue differently and credit balances are removed from the numerator and denominator, Tulsa and Oklahoma City are below 85 percent and Albuquerque is less than one percent over.

V.
COLLEGIATE COMPLIED WITH THE INTENT
OF THE 85 PERCENT RULE BY OBTAINING REVENUE FOR
INSTITUTIONAL COSTS FROM NON-TITLE IV SOURCES

The 85 Percent Rule was enacted to limit the amount of Title IV funding that a proprietary school could receive for tuition, fees and institutional charges in a fiscal year. Its intent, as the Secretary said,

"... is to require proprietary institutions to attract students based on the quality of their programs, not solely because the institutions offer Federal student financial assistance. Thus, under the statute, these institutions must attract students who will pay for their programs with funds other than Title IV, HEA program funds." *Exhibit 5, 59 Fed. Reg. 6446, 6448 (Feb. 10, 1994)*(emphasis added).

Taking this purpose into account as well as the limited financial ability of most Collegiate students, Collegiate designed a plan that required its students to

there is no basis to treat book revenue differently than equipment revenue, and the figures for "equipment and/or living expenses" are retained or added back as the OIG did, then the 85/15 percentage for Tulsa and Oklahoma City would be 84.6% and 86% for Albuquerque.

pay \$450 at \$50 per month toward the costs of their education, i.e., tuition, fees and institutional charges such as books, supplies and equipment. See *Exhibit 10*.

There should not be any question that these cash payments went toward tuition, fees and institutional charges. There should also not be any question that cash payments by students for tuition, fees and institutional charges are revenue that must be included in the denominator of the fraction.

Notwithstanding, the OIG has turned the student payments on their head by asserting that they should be treated as a "refund" of monies for living expenses. Factually, students were asked and agreed to pay \$450 towards meeting the cost of their education, an action completely in accordance with the intent of the law and regulation. Yet, according to the OIG, these payments should be refunded to the students to meet their living expenses. Needless to say, this defies common sense and amounts to saying that Collegiate should not have taken any money from the students and should have relied solely on Title IV revenue, the antithesis of the purpose for the 85 Percent Rule. In fact, the only way that Collegiate could have complied with the OIG interpretation would have been to refuse to permit students to pay for any costs of education with cash or to refuse to certify Title IV funding applications for the full amount the students were entitled to receive, actions that would have been in violation of law.

The basis for the OIG position is its reference to the regulatory presumption that all Title IV funds used by Collegiate are presumed to be used to pay for tuition, fees and institutional charges except under several specific conditions identified in the regulation, none of which are met by cash payments for tuition, fees and institutional charges by students. *Exhibit 1 at 5, 34 C.F.R. § 600.5(d)(2)(v)*.

Following this logic, the OIG added back an amount into the denominator attributed to student payments for "equipment and/or living expenses." *Exhibit 1 at Appendix 1 of 4 as an example*. In the example of Tulsa (*Exhibit 1 at Appendix 1 of 4*), the add back is \$6,369.50. In light of the prior section's analysis, any add back for equipment is clearly wrong. Unfortunately, the Draft Audit does not separate equipment from living expenses so further analysis, response and calculation is not possible.

Notwithstanding, Collegiate submits that no add back to the numerator is appropriate since the revenue received from students was clearly received for tuition, fees and institutional charges and is as close to the true definition of revenue that the Secretary was searching for as it is possible to get.

VI.
THE DEPARTMENT IS OBLIGATED TO APPLY ITS REGULATIONS
UNIFORMLY

The Higher Education Act requires the Secretary to uniformly apply and enforce his regulations throughout the country. 20 U.S.C. § 1232 (c). See *Chula Vista City School Dist. V. Bennett*, 824 F.2d 1573, 1583 (Fed. Cir. 1987), cert. den., 484 U.S. 1042 (1988); *In the Matter of Blair Junior College*, Dkt. No. 93-23-SP (June 1, 1994)(Dec. of ALJ Cross) at 26 (Exhibit 14); *In the Matter of Nettleton Junior College*, Dkt. No. 93-29-SP (June 8, 1994)(Dec. of ALJ Cross)(Exhibit 15). This principle is embodied in the concept of equal protection of the law. Equal protection "is essentially a direction that all persons similarly situated should be treated alike." *City of Cleburne, Texas v. Cleburne Living Center*, 473 U.S. 432, 439 (1985).

Were the Department to accept the interpretation of the 85 Percent Rule and institutional charge definition now being advanced by the OIG for 85/15 analysis to past years, this fundamental principle would be violated since other similarly situated Colleges are not being treated alike.

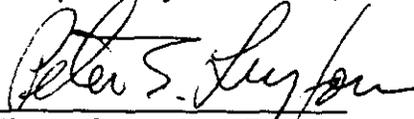
VII.
COLLEGIATE IS ENTITLED TO RELY ON ITS CALCULATION
WHICH WAS RENDERED IN GOOD FAITH AND WITH NO GUIDANCE
WITHOUT PENALTY OR THE THREAT OF PENALTY

Collegiate and its accountant calculated the 85/15 percentage in good faith and without adequate guidance from the Department or the OIG. The OIG does not question Collegiate's good faith. Good faith and reasonable interpretations of the law should be entitled to be made without threat of penalty, whether in terms of liabilities or eligibility.

VIII.
CONCLUSION

For the reasons advanced above, the OIG should conclude that Collegiate's method of calculating 85/15 was correct and that the calculations are each below 85%. Accordingly, it should withdraw its recommendations.

Respectfully submitted,



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Dated: June 17, 1999

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