Academy Pacific Business & Travel College
Eligibility To Participate In Title IV Programs

FINAL AUDIT REPORT

Audit Control Number
A0980023
December 1998

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
Sacramento, California

NOTICE

Statements that financial and/or managerial practices need improvement or recommendations that costs questioned be refunded or unsupported costs be adequately supported, and recommendations for the better use of funds, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determinations on these matters will be made by the appropriate Education Department officials.

U.S. DEPARTMENT OF EDUCATION

Office of Inspector General
801 I Street, Suite 219
Sacramento, CA 95814

MEMORANDUM

DATE: December 21, 1998

TO: Mr. Greg Woods
Chief Operating Officer
Office of Student Financial Assistance Programs

FROM: Regional Inspector General for Audit
Region IX

SUBJECT: FINAL AUDIT REPORT
"Academy Pacific Business & Travel College Eligibility To Participate In Title IV Programs."
ED Audit Control No. A0980023

Attached is our subject audit report presenting our finding and recommendations resulting from our audit of Academy Pacific Business & Travel College, Los Angeles, California.

In accordance with the Department's Audit Resolution Directive, you have been designated as the action official responsible for the resolution of the finding and recommendations in this report.

If you have any questions or wish to discuss the contents of this report, please contact me at (916) 498-6622. Please refer to the above audit control number in all correspondence relating to this report.

GLORIA PILOTTI
Regional Inspector General
for Audit

Attachment

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Executive Summary

Academy Pacific Business & Travel College (Academy Pacific), a proprietary institution located in Los Angeles, California, did not qualify as an eligible institution for participation in the Title IV Student Financial Assistance Programs. The 1992 reauthorization of the Higher Education Act (HEA), added a provision to the Act requiring that a proprietary institution must derive at least 15 percent of its revenues from non-Title IV sources to participate in Title IV programs. This requirement is referred to as the 85 Percent Rule. That is, no more than 85 percent of a proprietary school's revenues, generated from tuition, fees and other institutional charges for eligible programs, may be derived from Title IV Programs.

Academy Pacific received only 12.41 percent of its revenues from non-Title IV sources during the fiscal year ended December 31, 1995. As a result, the institution was ineligible to participate in the Title IV programs as of January 1, 1996. Academy Pacific also failed to meet the 85 Percent Rule in its fiscal years ended December 31, 1996 and 1997.

In the notes to its financial statements, Academy Pacific had reported to the U.S. Department of Education that it met the 85 Percent Rule. However, we found that Academy Pacific had improperly included amounts for institutional scholarships, institutional matching contributions and institutional loans when calculating its percentages. These amounts did not represent non-Title IV cash revenue received by the institution. We also concluded that the validity of the institutional scholarships was questionable.

We recommend that the Chief Operating Officer for the Office of Student Financial Assistance Programs (OSFAP) take emergency action to terminate participation of Academy Pacific in the Title IV programs. The Chief Operating Officer should also require that Academy Pacific return Federal grants received and ensure that the Department is made whole for Federally-guaranteed and Federal Direct loans disbursed since January 1, 1996. As of May 31, 1998, Academy Pacific had received $1,935,364 in grants and disbursed $4,714,324 of loans for periods after the institution became ineligible.

Academy Pacific did not agree with our finding and recommendations. In its response to the draft report, the institution explained its rationale for including institutional scholarship and matching contribution amounts in the 85 Percent Rule calculation. The explanation and information contained in the Academy Pacific's response did not change our conclusions.

Audit Results

We concluded that Academy Pacific had not derived 15 percent of its revenues from non-Title IV sources during its fiscal years ended December 31, 1995, 1996 and 1997. Academy Pacific had calculated its percentage of revenues from Title IV programs and reported the percentage in its financial statements. However, the percentage of Title IV revenues was understated because Academy Pacific had improperly included institutional scholarships, institutional matching contributions and institutional loan principal as non-Title IV revenue in its 85 Percent Rule calculation.

Academy Pacific Failed to Meet the 85 Percent Rule

As of January 1, 1996, Academy Pacific did not qualify as an eligible proprietary institution of higher education because revenues from Title IV programs exceeded 85 percent of revenues. The 1992 reauthorization of the Higher Education Act (HEA), added a provision to the Act that states *"the term 'proprietary institution of higher education' means a school . . . which has at least 15 percent of its revenues from sources that are not derived from* [HEA, Title IV] *funds . . . ."*[1] This institutional eligibility requirement is codified in Title 34 of the Code of Federal Regulations (CFR), Section 600.5(a)(8). The regulations also provide the formula for assessing whether an institution has satisfied the requirement and specify that amounts used in the formula must be received by the institution during its fiscal year. Specifically, 34 CFR Section 600.5(d)(2)(i), states that *"...the title IV, HEA program funds included in the numerator and the revenue included in the denominator are the amount of title IV, HEA program funds and revenues received by the institution during the institution's last complete fiscal year."*

Academy Pacific's receipts from non-Title IV sources were less than 15 percent of its revenues. The following table summarizes our analysis of revenues for Academy Pacific. The amounts shown are for Academy Pacific's fiscal years ending December 31.

[1]This provision was contained in HEA Section 481(b)(6). The 1998 Amendments to the HEA, which were enacted on October 7, 1998, changed this provision to require that a proprietary institution has at least 10 percent of revenue from non-Title IV sources.

Table 1. OIG's Computation of Academy Pacific's Percentage of Non-Title IV Funds. *Academy Pacific did not have sufficient non-Title IV revenues to meet the 15 percent minimum.*

	Academy Pacific Business & Travel College		
	1995	**1996**	**1997**
Title IV Receipts	$2,562,241	$2,177,383	$3,157,647
Non-Title IV Receipts	$362,968	$284,759	$186,463
Total Revenue (Cash Basis)	$2,925,209	$2,462,142	$3,344,110
Non-Title IV Funds as a Percent of Total Revenue	**12.41%**	**11.57%**	**5.58%**

Table 1 shows that the non-Title IV revenues represented less than 15 percent of Academy Pacific's total revenues for 1995, 1996 and 1997. The 85 Percent Rule became effective on July 1, 1995. Therefore, the institution was ineligible to receive Title IV funds as of January 1, 1996 (the first day after its fiscal year end).

The non-Title IV receipts shown in Table 1 are comprised of amounts that Academy Pacific identified as cash received from individual students payments, a Job Training Partnership Act program and a Vocational Rehabilitation program. We did not perform audit tests to confirm these receipts. Such test were not necessary to support our conclusions since the total of the amounts identified were below the 15 percent level required by the HEA.

Academy Pacific improperly included amounts in its 85 Percent Rule calculations which did not represent non-Title IV cash received. When Academy Pacific calculated its percentage of revenues from Title IV sources, it improperly included its institutional scholarships, institutional matching contributions, and institutional loan principal as non-Title IV revenues. The inclusion of these items gave the impression that Academy Pacific met the 85 Percent Rule, when, as noted in the previous section, they had not met the requirement. The following table shows the amounts that Academy Pacific included in its computations:

Table 2. Academy Pacific's Computation of Percentage of Non-Title IV Funds. *The inclusion of the institutional scholarships, institutional matching contributions, and institutional loan principal gave the impression that Academy Pacific met the 85 Percent Rule.*

	Academy Pacific Business & Travel College		
	1995	**1996**	**1997**
Title IV Revenue	$2,562,241	$2,177,383	$3,157,647
Other Revenue:			
Individual Student Payments	$ 261,318	$ 188,866	$ 163,460
Scholarships	212,110	106,453	308,586
Institutional Matching Contributions	41,520	27,669	71,263
Institutional Loan Principal	- 0 -	22,324	64,173
Vocational Rehabilitation Program	101,650	67,700	18,053
Job Training Partnership Act Program	- 0 -	28,193	4,950
Total Other Revenue	$ 616,598	$ 441,205	$ 630,485
Total Revenue (Title IV and Other)	$3,178,839	$2,618,588	$3,788,132
Other Revenue as a Percent of Total Revenue	**19.40%**	**16.85%**	**16.64%**

Amounts used in the 85 Percent Rule calculation must represent actual cash received. In the regulations (34 CFR Section 600.5(d)(2)(i)), the Department specified that the amounts to be used in the calculation are Title IV funds and revenues **received by** the institution during the fiscal year. Thus, the regulations required that the amounts used in the formula represent actual amounts received. The accounting method that recognizes revenues when amounts are received is referred to as cash-basis accounting.[2]

When the regulations covering the 85 Percent Rule were issued on April 29, 1994, the Department clarified that revenues must be reported on a **cash-basis** method in both the numerator and denominator of the formula. In the *Analysis of Comments and Changes* section of the Final Rule, the Secretary stated that:

> *"... since institutions must report and account for title IV, HEA program funds on a cash basis, the institution must also account for revenue in the denominator on a cash basis. Under a cash basis of accounting, the institution reports revenues on the date that the revenues are actually received."*

Also, the *Analysis of Comments and Changes* section of the Final Rule stated the Department's position on including institutional scholarships and institutional loans as revenue.

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[2] In contrast, the accrual basis of accounting recognizes revenue when sales are made or services are performed, regardless of when cash is received.

*"An institution is not prohibited from including institutional charges that were **paid*** [emphasis added] *by institutional scholarships and institutional loans as revenue ... provided that the scholarships and loans are valid and not just part of a scheme to artificially inflate an institution's tuition and fee charges. For this purpose, the Secretary does not consider institutional loans to be real unless such loans are routinely repaid by the student borrowers. The Secretary does not consider institutional scholarships to be valid if every student receives such a scholarship so that no student ever pays the claimed tuition and fee charges...*

In this connection, the Secretary will scrutinize institutions that raise their tuition and fee charges to avoid the 85 percent rule but can show no actual payment of those additional charges, or payment through 'artificial' institutional scholarships and loans."

Institutional scholarship amounts included in Academy Pacific's calculations do not represent cash received and the validity of the scholarships is questionable. During the enrollment process, the student signs a retail installment contract with Academy Pacific. The contract shows the school's tuition charges and the student's method of payment. Academy Pacific students may pay the tuition with a combination of anticipated Title IV funds[3] and non-Title IV funds such as cash payments from students, the Vocational Rehabilitation Program and the Job Training Partnership Program. If the amount of Title IV funds and non-Title IV cash payments are not sufficient to cover the tuition, Academy Pacific notes on the contract that the balance (unmet need) is covered by an institutional loan. Academy Pacific defines "unmet need" as the amount of the tuition not covered by anticipated Title IV funds and non-Title IV cash payments, including anticipated student cash payments. The terms of the institutional loan are specified on the retail installment contract. At the time of our review, 230 students who had enrolled during calendar year 1997 had completed their educational programs. Of these 230 students, 58 students had an "unmet need." All 58 students had institutional loans for the amount of their "unmet need."

Students with an "unmet need" are informed at the time of enrollment that they may receive an institutional scholarship in the amount of the institutional loan. A scholarship form is completed that shows the scholarship amount and the requirement that the student must complete their educational programs with at least a 3.0 grade point average and attend at least 90 percent of classes to be eligible for the scholarship.

We concluded that Academy Pacific's institutional scholarships had no value under a cash-basis method of accounting. When students complete their educational programs, Academy Pacific records a credit in the student accounts for the amount of the institutional loans.[4] These transactions involved no receipt or disbursement of cash.

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[3] Funds from Pell Grants, Direct Loans, Federal Family Education Loans (subsidized and unsubsidized), PLUS Loans, Perkins Loans, Supplemental Educational Opportunity Grants and Federal Work Study.

[4] If the student made any payments on the institutional loan after graduation school, Academy Pacific credits the student account for the original amount of the loan and reimburses the student for the payments that they have made.

Also, Academy Pacific did not have an external source of scholarship funds. The cash-basis of accounting recognizes revenues when cash is received and recognizes expenses when cash is paid out.[5] Since the scholarship credits involved no receipt or payment of cash, the scholarship credits had no value under a cash basis method of accounting. Academy Pacific should not have included scholarship credits in its 85 Percent Rule calculations.

We also question the validity of Academy Pacific's scholarship program. Academy Pacific's Financial Aid Administrator informed us that the school has not followed the scholarship policy outlined on the scholarship form. Since 1994, Academy Pacific's President has authorized a scholarship credit for all students with an "unmet need" who complete their educational programs, regardless of the student's grade point average and attendance record. Of the 58 students with "unmet need" who completed their educational programs in calendar year 1997, 38 had met the school's scholarship requirements and received a scholarship credit. The remaining 20 student with "unmet need" completed their programs but did not meet the school's scholarship requirements. These 20 students also received a scholarship credit or were scheduled to receive the credit.[6] By not following its policy, Academy Pacific's scholarship program may no longer be a valid program.

Institutional matching contributions do not represent cash received. Institutional matching contributions are Academy Pacific's own funds that it was required to make available to students under the College Work Study (CWS), Supplemental Educational Opportunity Grant (SEOG) and Perkins Loan programs. These matching contributions are derived from checks being issued from one of the school's accounts and deposited into another school account. The matching contributions represent cash transfers between institution accounts, but they are not revenue. Revenues are the inflows of assets resulting from the sale of products or the rendering of services to customers.[7] Academy Pacific included institutional matching contributions for the SEOG and Perkins Loan Programs in its 85 Percent Rule calculation. The matching contributions should not have been included in the calculation.

Institutional loan principal amounts do not represent cash received. The institutional loan principal amounts represent the portion of the loan that the school has earned by providing educational services to the students. As mentioned earlier, cash-basis accounting recognizes revenue when cash is received rather than when services are provided. Therefore, the institutional loan principal amounts should not have been included in the 85 Percent Rule calculation. Amounts actually paid by students on the school's institutional loans were included in the individual student payments amounts shown in Table 2.

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[5] Hermanson, Roger H., ed. 1992. *Accounting Principles,* Homewood, IL: Richard D. Irwin, Inc.

[6] Academy Pacific included the scholarship amounts for students who received credit as well as those who were scheduled to receive credit in the 85 Percent Rule calculation for its fiscal year ended December 31, 1997.

[7] Hermanson, Roger H., ed. 1992. *Accounting Principles,* Homewood, IL: Richard D. Irwin, Inc.

Academy Pacific was ineligible for Title IV funds it received since January 1, 1996. Institutions that fail to satisfy the 85 Percent Rule lose their eligibility to participate in Title IV programs on the last day of the fiscal year covering the period that the institution failed to meet the requirement. Because it did not meet the 85 Percent Rule for its fiscal year ended December 31, 1995, Academy Pacific lost its eligibility to participate on January 1, 1996. The following table shows the amounts of Title IV funds that, as of May 31, 1998, Academy Pacific had received since its loss of eligibility.[8]

Table 3. Title IV Funds Received By Academy Pacific After January 1, 1996. *Academy Pacific received over $6.6 million in Title IV program funds after it became ineligible to participate in those programs.*

Title IV Sources	Academy Pacific Business & Travel College			
	Fiscal Year Ended December 31,1996	Fiscal Year Ended December 31,1997	January 1 through May 31, 1998	Total
Pell Grants	$552,396	$805,584	$311,332	$1,669,312
SEOGs	100,278	139,838	25,936	266,052
Total Grants	$652,674	$945,422	$337,268	$1,935,364
Stafford Loans (subsidized)	497,416	980,413	394,019	1,871,848
Stafford Loans (unsubsidized)	565,112	872,450	416,810	1,854,372
PLUS Loans	171,565	253,449	- 0 -	425,014
Direct Subsidized Loans	175,815	519	- 0 -	176,334
Direct PLUS Loans	77,862	- 0 -	169,318	247,180
Perkins Loans	30,850	101,240	7,487	139,577
Total Loans [9]	$1,518,620	$2,208,071	$987,634	$4,714,325
Total Title IV Funds	$2,171,294	$3,153,493	$1,324,902	$6,649,689

[8] The grant and loan amounts shown in Table 3 are the total of funds disbursed as shown by Academy Pacific records.

[9] Academy Pacific also received Title IV funds from the Federal Work Study (FWS) program which were not included in this table.

Recommendations

We recommend that the Chief Operating Officer for OSFAP:

1. Initiate emergency action to terminate the participation of Academy Pacific in Title IV programs.

2. Require that Academy Pacific return Pell grant and SEOG funds received after January 1, 1996. As of May 31, 1998, Academy Pacific's records showed that those grant funds total $1,935,364.

3. Ensure that the Department is made whole for loans disbursed by Academy Pacific since January 1, 1996. The amount recovered to make the Department whole should include the interest and special allowances incurred on those loans. Academy Pacific records show that, as of May 31, 1998, the school had disbursed a total of $4,714,325 of such loans.

Academy Pacific's Comments

In its response to our report, Academy Pacific stated that the institution had made a good faith effort to comply with the 85 Percent Rule regulations. It noted that nowhere in the Federal regulations are the words "cash basis" mentioned, except in the *Analysis of Comments and Changes* section of the Final Rule. Academy Pacific expressed its opinion on cash basis accounting and cited accounting procedures described in Departmental publications from which the Academy concluded that the Department acknowledged "tuition waivers" as an exception within cash basis of accounting.

Academy Pacific stated that, after reading the *Analysis* section on institutional scholarships and loans, it concluded that its own scholarships and the principle on its loans met the requirements for inclusion in the 85 Percent Rule calculations. The Academy explained that since the scholarship and loan funds are by definition institutional in their source, the commonly accepted procedure of a "tuition waiver" to post the student's account seemed logical. As additional support for its position, Academy Pacific also referred to a statement signed by one of the Department's Senior Program Specialist. The Academy stated that its policy of awarding additional scholarships at the end of the fiscal year is clearly stated in its written scholarship policy.

Academy Pacific explained that its decision to include matching funds for Perkins Loans and SEOG was made after consulting with its Certified Public Accountant and professional associations. According to the Academy, all were in agreement that since the regulations stated only that the funds were not to be included as Federal revenue, it was logical that they belonged as school revenue. The Academy stated that Departmental policies do not contain a statement that matching funds are not to be included at all in the 85 Percent Rule calculation.

OIG Response

The Academy Pacific's comments did not change our position. As we noted earlier, the Federal regulations specifically state that the amounts used in the calculation are Title IV funds and revenues "received by" the institution during the fiscal year. The accounting method that recognizes revenues when received is the cash basis method.

The SFA publications cited in Academy Pacific's response regarding the reporting of tuition waivers are not applicable to the 85 Percent Rule. Even if the instructions in those publications were applicable, the scholarship amounts could not be included in the 85 Percent Rule calculation. The HEA provision which enacted the 85 Percent Rule and the Federal regulations that implemented the Rule are both explicit — "revenue" derived from non-Title IV sources is to be used in the 85 Percent Rule calculation. Tuition waivers are not revenue to the institution.

The Financial Accounting Standards Board (FASB) provides a definition of revenue in its Statement of Financial Accounting Concepts No. 6. The FASB defines revenues as *"inflows or other enhancements of assets of an entity or settlements of its liabilities (or combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entities ongoing major or central operations."* The FASB Statement also states that *"Revenues represent actual or expected cash inflows (or the equivalent) that have occurred or will eventuate as a result of the entity's ongoing major or central operations."* [10]

Academy Pacific's awarding of scholarships (tuition waivers) did not provide inflows of cash or other assets. Therefore, the scholarships do not meet the FASB's definition of revenue. In fact, when Academy Pacific recorded a scholarship credit in student accounts, the transaction reduced rather than increased its expected cash inflows (student balances due).

The Analysis section on institutional scholarships and loans does not provide justification for including Academy Pacific's scholarship credits as non-Title IV revenue. The Academy had no external source of scholarship funds. The scholarship credits involved no receipt or payment of cash and, thus, had no value under a cash basis method of accounting. Our conclusion that no value was received by the institution is further supported by the facts that Academy Pacific did not report the scholarships as revenue to the Internal Revenue Service on its 1997 tax return. The statement signed by the U.S. Department of Education official was merely a restatement of a portion of the *Analysis* section.

Academy Pacific's Scholarship Policy identifies five specific criteria for consideration in the scholarship program, including a grade average of 3.0 or higher and an attendance percentage of 90 or higher. An Academy Pacific official informed us that school has not followed the scholarship policy outlined on the scholarship form. Since 1994, Academy Pacific's President has authorized a scholarship credit for all students with an "unmet need" who complete their educational programs regardless of the student's grade point average or attendance record. At the end of each year the

[10] FASB's Statement of Financial Accounting Standards No. 95 defines "cash equivalents" as short-term, highly liquid investments that are both readily convertible to known amounts of cash and so near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

school provides a statement to their Independent Public Accountant (IPA) for inclusion in the financial statements that states that a scholarship will be given to all students who graduated during that year.

There is no need for Federal regulations covering the 85 Percent Rule to specifically address matching contributions. Institutional matching contributions do not meet the FASB definition of revenue. The matching contributions represent solely cash transfers between institutional accounts. The transfers do not result in inflows of cash or other assets to the institution.

Other Matters

During our fieldwork, we met with representatives of the Certified Public Accountant (CPA) firm that reviewed Academy Pacific's financial statements for fiscal years ended December 31, 1996 and 1997. Our purpose was to obtain information on the extent of the CPA firm's review of amounts included in Academy Pacific's 85 Percent Rule calculation and its basis for concluding that the calculation was properly performed by the institution.

The CPA firm representative explained that his review included tracing scholarship amounts used in the 85 Percent Rule calculation to the institution's general ledger. The CPA firm believed that it was proper to include the scholarship amounts since Academy Pacific does not give scholarships to all students. The CPA firm used information contained in the product available from EDTECH, Inc (called Toolkit *PLUS*) for guidance on the requirements of the 85 Percent Rule. The EDTECH product included the statement that "institutions will use a cash basis of accounting for both Title IV, HEA program funds and revenues." As noted in our report, Academy Pacific's scholarships had no value under cash-basis accounting.

Background

Academy Pacific Business & Travel College (Academy Pacific) was founded in 1948 and currently operates as a proprietary institution located in Los Angeles, California. Academy Pacific is accredited by the Accrediting Commission of Career Schools and Colleges of Technology. The institution offers vocational programs in Flight Attendant and Travel-Tourism Management.

During the period January 1, 1995 through May 31, 1998, Academy Pacific received about $9.2 million in Title IV funds from the following programs: Pell Grant Program, Federal Supplemental Educational Opportunity Grant Program, Federal Family Education Loan Program, William D. Ford Federal Direct Loan Program and Federal Perkins Loan Program. Academy Pacific also participated in the Federal Work Study Program.

Purpose and Methodology

The objective of our audit was to determine whether Academy Pacific derived at least 15 percent of its revenues from non-Title IV sources and properly reported its 85 Percent Rule percentage in its financial statements and if applicable, to the U.S. Department of Education.

To accomplish our objective, we obtained background information about the institution. We reviewed selected Academy Pacific's student files and Departmental records. We reviewed Academy Pacific's corporate financial statements and the most recent Student Financial Assistance (SFA) audit reports prepared by its Certified Public Accountant. We also conducted interviews with Academy Pacific officials and staff. Additionally, we confirmed that the institution used the 85 Percent Rule formula specified in the regulations and reported its 85 Percent Rule percentage in its financial statements.

To achieve our audit objective, we performed an analysis of and used information extracted from Academy Pacific's student account ledgers which are maintained on a computerized database. Information from student account ledgers that we used as a basis for an audit conclusion was confirmed with other sources, such as institutional bank statements and student records. We used data extracted from the Department's National Student Loan Data System (NSLDS) and reports generated from the Department's Postsecondary Education Participants System (PEPS) for background information purposes.

Our audit covered the institution's fiscal year ending December 31, 1997. After determining that Academy Pacific did not meet the 85 Percent Rule in fiscal year 1997, we expanded our scope to include the fiscal years ended December 31, 1995 and 1996. We performed fieldwork at Academy Pacific from May 14, 1998 through June 5, 1998. Additional work was completed in the Long Beach office through July 1, 1998. Our audit was performed in accordance with generally accepted government auditing standards appropriate to the scope of the review described above.

Statement on Management Controls

As part of the review, we assessed Academy Pacific's management control structure, as well as its policies, procedures, and practices applicable to the scope of the audit. The purpose of our review was to assess the level of control risk for determining the nature, extent, and timing of our substantive tests. For the purpose of this report, we assessed management controls related to the institution's calculation and reporting of its percentage of revenues from non-Title IV sources as required by the 85 Percent Rule.

Because of inherent limitations, a study and evaluation made for the limited purposes described above would not necessarily disclose all material weaknesses in the control structure. However, our assessment disclosed weaknesses in the procedures used to calculate the percentage. These weaknesses are discussed in the Audit Results section of this report.

Attachment
Academy Pacific's Response

ACADEMY PACIFIC

Business and Travel College

September 23, 1998

Gloria Pilotti
Regional Inspector General for Audits
Region IX
501 W. Ocean Blvd. Suite 1200
Long Beach, CA 90802

Dear Ms. Pilotti,

In response to your audit report of September 3, 1998, concerning Academy Pacific's compliance with the 85% rule, I do not concur with the findings or the recommendations of the report.

Since the implementation of the 85% rule in 1995, Academy Pacific has made a good faith effort to comply with the regulation. With limited guidance from the Department of Education on what may be included as revenue, Academy Pacific consulted with our C.P.A. firm, Kelman & Chan; professional associations including the Career College Association, and other institutions in an attempt to make sense of the policy and implement a procedure to ensure the school's compliance. 34CFR 600.5 (d) (1) (2) states "The sum of revenues generated by the institution from: Tuition, fees, and other institutional charges for students enrolled in eligible programs as defined in 34CFR 668.8; and activities conducted by the institution, to the extent not included in tuition, fees, and other institutional charges, that are necessary for the education or training of its students who are enrolled in those eligible programs." Then it went on to say that the revenues included in the numerator and the denominator are the amount of Title IV HEA program funds and revenues received by the institution during the institution's last completed fiscal year. Nowhere in the regulations are the words "cash basis" mentioned, except in the discussion contained in the Federal Register Vol 59 No 82 dated April 29, 1994.

The cash basis of accounting in its pure form recognizes revenues and expenses based on the receipt and disbursement of cash. The pure cash basis treats all disbursements of cash as expenses; thus the purchase of fixed assets or inventory is recognized as an expense rather than an asset. Stated another way, under a pure cash basis of accounting, the conventional balance sheet contains only cash and equity, and the conventional income statement reflects all cash receipts as revenues and all cash disbursements as expenses. In practice, the pure cash basis of accounting rarely is used. Instead, the cash basis of accounting has generally become recognized as a hybrid or modification of the cash-accrual basis.

Furthermore, after reading the Analysis of Comments and Changes section of the Final Rule, we concluded that our Institutional Scholarships and Institutional Loan Principle met the criteria described. That discussion states: "An institution is not prohibited from including institutional charges that were paid by institutional scholarships and institutional loans as revenue in the denominator of the fraction contained in Sec. 600.5 (d) (1)". Since these funds are by definition institutional in their source, the commonly accepted procedure of a "tuition waiver" to post the student's account seemed logical.

Accredited by the Accrediting Commission of Career Schools and Colleges of Technology
1777 NORTH VINE STREET, LOS ANGELES, CA 90028-5218 (213) 462-3211 FAX (213) 462-7755

The Federal Student Aid Handbook clearly states that institutional funds may be in the form of a "waiver of tuition or fees" such as in the case of FSEOG matching funds. (1998-99 Handbook p. 8-12) Also, instructions contained in The Fiscal Operations Report for 1997-98 and Application to Participate for 1999-2000 direct schools to convert tuition waivers to a cash value for reporting purposes. (FISAP Report Instructions Booklet p.34 and 36.)

In light of the fact that accounting procedures acknowledge exceptions within the cash basis of accounting, and that the Department of Education has yet to define their interpretation of the terms "cash" and "paid" in the context of the 85% Rule, Academy Pacific made a good faith decision to include these amounts in the calculation.

Academy Pacific's procedure of awarding scholarships to eligible students is to forgive the amount that the students owe to the institution. The revenue had been recognized as the student completed the course. Since the scholarship is awarded by the institution internally rather than from an outside source, there was no actual cash received. The determining event that dictates the recognition of revenues is when the scholarship was awarded. While the Inspector General report questions the "validity" of some of the scholarships awarded, our policy of awarding additional funds at the end of the fiscal year is clearly stated in our written scholarship policy which was made available to the auditors. Academy Pacific is unaware of any Department of Education scholarship policies which we have violated.

Academy Pacific included the institutional matching funds for Perkins and FSEOG in our 85/15 calculation. (We did not include matching funds for FCWS as implied in your report.) With no clarification from the Department of Education, this decision was based again on consultation with our CPA and professional associations. All were in agreement that since the regulations stated only that the funds were not to be included as Federal revenue, it was logical that they belonged as school revenue. The institution's matching contribution amount represents actual cash receipts and therefore should be included in the revenues. Institutional matching contributions are required by the Title IV HEA programs. We could find no statement in Dept. of Education policies that the funds are not to be reported at all, as your report states.

Subsequent to your audit at Academy Pacific, we have been made aware of a clarification of the 85% Rule by Cheryl Leibovitz, Senior Program Specialist for the Department of Education's Division of Policy Development, that institutional loans are to be included in the denominator "in the year they are made." In order to comply with this policy clarification, Academy Pacific has recalculated our 85/15 figures for the years 1995, 1996, and 1997 and are included here as Exhibit #1.

We recognize that your organization is important for the protection of students against unscrupulous schools. Your careful investigation of organizations such as ours is therefore appreciated. On November 12, our school is celebrating with our Congressmen, Mayor, Chamber of Commerce leaders, and other dignitaries our fiftieth anniversary under the same management. Throughout these years our school has been audited periodically by all the regulatory institutions and has remained in compliance.

Respectfully yours,

Marsha Toy

Marsha Toy
President

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Joseph Tong
Mona Samuels-Sego, Long Beach Oversight, MBA, CFE, CGFM
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