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OFFICE OF INSPECTOR GENERAL

AUDIT SERVICES  
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James W. Runcie  
Chief Operating Officer  
U.S. Department of Education  
Federal Student Aid  
830 First Street, N.E.  
Washington, DC 20202

Dear Mr. Runcie:

This final audit report, “Federal Student Aid’s Processes for Identifying At-Risk Title IV Schools and Mitigating Potential Harm to Students and Taxpayers,” presents the results of our audit. The purpose of the audit was to assess Federal Student Aid’s (FSA) processes for identifying Title IV schools at risk of unplanned closure<sup>1</sup> and mitigating the potential harm to students and taxpayers. Our review covered January 2012 through July 2016, which enabled us to see how FSA’s processes have changed since fiscal issues first emerged at Corinthian Colleges, Inc. (Corinthian) in February 2012 and the subsequent closure of its schools in April 2015. We determined that FSA has enhanced its processes in this area, but further improvements are needed. Specifically, FSA needs to improve its processes for reviewing a school’s composite score calculation and any related composite score appeal made by a school. FSA also needs to implement controls to prevent schools from manipulating composite scores to avoid sanctions or increased oversight by FSA.

In the section “Other Matter,” we highlight some of the benefits that the new borrower defense regulations, if enforced, could provide FSA in its monitoring efforts and improve FSA’s ability to identify Title IV schools at risk of unexpected or abrupt closure.

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## **BACKGROUND**

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Title IV of the Higher Education Act of 1965, as amended (Title IV), authorizes various programs that provide financial aid, typically in the form of grants or loans, to eligible students enrolled in eligible programs at eligible postsecondary schools (schools). According to FSA, for Federal award year (AY) 2014–2015, more than 6,100 schools enrolled students receiving Title IV assistance and thus participated in the Title IV programs. These schools included universities, colleges, and vocational schools. Participating schools may be public, private

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<sup>1</sup> In the remainder of this report, we refer to an unplanned closure as an “unexpected or abrupt” closure.

nonprofit, or private for-profit (proprietary) entities; some for-profit schools are publicly traded as well. Table 1 shows the number of schools and Title IV funding by ownership type for AY 2014–2015.

**Table 1. Number of Schools and Amount of Title IV Funding by Ownership Type for AY 2014–2015 (Funding in Billions)**

School Ownership Type	Number of Schools	Title IV Funding	Percent of Total Title IV Funding
<b>Public Schools</b>	<b>2,171</b>	<b>\$67.1</b>	<b>51.4%</b>
<b>Private Nonprofit Schools</b>	<b>1,816</b>	<b>\$41.0</b>	<b>31.4%</b>
<b>Proprietary Schools</b>	<b>2,200</b>	<b>\$22.5</b>	<b>17.2%</b>
<i>Publicly traded</i>	189	\$12.4	9.5%
<i>Privately held</i>	2,011	\$10.1	7.7%
<b>Total, All Schools</b>	<b>6,187</b>	<b>\$130.6</b>	<b>100.0%</b>

Source: FSA’s AY 2014–2015 Funding Data Summary Report

FSA is a performance-based organization within the U.S. Department of Education (Department) responsible for managing the administrative and oversight functions supporting the Title IV programs, including ensuring the integrity of the programs (Sections 141(a)(1) and (b)(2)(A)(vi) of the Higher Education Act of 1965, as amended (HEA)). As part of its oversight responsibilities, FSA is responsible for ensuring that schools are financially responsible and administratively capable of properly managing the Title IV programs (34 Code of Federal Regulations (C.F.R.) Sections 668.16 and 668.171).<sup>2</sup> FSA determines whether a school is financially responsible based on the school’s ability to provide the services described in its official publications and statements, properly administer the Title IV programs in which it participates, and meet all of its financial obligations (34 C.F.R. Section 668.171(a)).

Schools must demonstrate that they are financially responsible by meeting general standards and performance and affiliation standards.<sup>3</sup> Public schools meet the general standards of financial responsibility if their debts and liabilities are backed by the full faith and credit of the State or other government entity they are authorized by.<sup>4</sup> A proprietary or private nonprofit school meets the general standards of financial responsibility if FSA determines that the school (a) has a passing composite score; (b) has sufficient cash reserves to make required refunds, including the return of Title IV funds; (c) is meeting all of its financial obligations; and (d) is current in its debt payments. A school generally meets the performance and affiliation standards if it (a) has not been subject to a limitation, suspension, or termination action in the last 5 years; (b) has not had program review or audit findings for the current fiscal year (FY) or two preceding fiscal years that required repayment of more than 5 percent of the Title IV funds it received; (c) has not been cited during the last 5 years for failing to submit required audits; (d) has satisfactorily resolved

<sup>2</sup> All regulatory citations are from the July 1, 2014, volume of 34 C.F.R.

<sup>3</sup> General standards are basic standards that FSA uses to evaluate a school’s financial health. Performance and affiliation standards are standards that FSA uses to evaluate a school’s past performance and individuals affiliated with the school.

<sup>4</sup> A public school must notify FSA that it is designated as a public school by the State or other government entity that has the legal authority to make that designation and provide FSA with a letter from an official of the appropriate government entity confirming the school’s status as a public school.

any compliance issues identified in program reviews or audit reports; and (e) does not employ a person (who exercises substantial control over the school) who owes a liability for a Title IV violation. (See 34 C.F.R. Section 668 Subpart L.)

Schools are required to submit financial information to FSA each year so it can evaluate a school's financial responsibility. A school must provide this financial information in the form of an audited financial statement as part of a combined submission that also includes the school's compliance audit. Proprietary schools have 6 months from the end of their fiscal year to provide this information; private nonprofit and public schools have 9 months. FSA generally does not consider a school to be financially responsible if it fails to submit its audited financial statements and compliance audit within these timeframes or if in the school's audited financial statements, the auditor expressed other than an unqualified opinion (for example, adverse, qualified, or disclaimed) or doubt about the continued existence of the school as a going concern. (See 34 C.F.R. Sections 668.23, 668.171(d)(1), and 668.174(a)(3); Section 487(c)(1)(A) of the HEA; 2015–2016 FSA Handbook; and 31 U.S. Code § 7502(h)(2)(B).)

### Composite Scores

The composite score, which is calculated only for private nonprofit and proprietary schools, reflects the overall relative financial health of a school using a scale from negative 1.0 to positive 3.0. The score is a composite of three ratios (primary reserve, equity, and net income ratios) derived from fiscal information in a school's audited financial statements. A school with a composite score equal to or greater than 1.5 (*passing* score) is financially responsible. A school with a composite score of less than 1.5 but greater than or equal to 1.0 (*zone* score) is technically not financially responsible but generally may continue to participate in the Title IV programs as a financially responsible school for up to 3 consecutive years with additional oversight from FSA. A school with a *zone* score is subject to cash monitoring and other participation requirements. A school with a score below 1.0 (*failing* score) is not financially responsible. (See 34 C.F.R. Sections 668.171, 668.172, and 668.175.)

A school with a failing composite score must either provide FSA with an irrevocable letter of credit (LOC) made payable to the Department or provide funds directly to FSA in an amount that equals the LOC amount to continue participating in the Title IV programs (34 C.F.R. Section 668.175(c) and (f)(2)(i)). An LOC is a financial guarantee from a financial institution for the benefit of the Department, thereby assuring the availability of funds to pay liabilities that would be owed should a school unexpectedly or abruptly close or terminate classes at other than the end of an academic period.<sup>5</sup> An LOC provides assurance to the Department that funds would be available to make required refunds to students, provide teach-out facilities,<sup>6</sup> or meet institutional obligations to the Department.

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<sup>5</sup> An LOC is generally in effect for one year from the date of the condition causing the LOC, subject to annual renewals if the condition persists. An LOC required for late or unmade refunds or for past performance issues must be in effect for at least 2 years and 5 years, respectively.

<sup>6</sup> When a school closes, students may choose to attend a teach-out institution to the extent one is available. A teach-out institution is another school that offers to allow a student to complete a similar or identical program of study.

## **FSA Identification and Monitoring of Title IV Schools at Risk of Unexpected or Abrupt Closure**

FSA performs a formal school risk assessment each year. The assessment generates a risk score for all eligible and certified domestic schools participating in Title IV programs. FSA uses this information to help it select schools for program reviews. According to the director of FSA's School Eligibility Service Group (School Eligibility), the goal is to conduct about 300 program reviews each year, of which half should be reviews of schools that are among the top 500–600 most risky schools as ranked in the annual school risk assessment. FSA completed an average of 245 program reviews each year from FY 2011 through FY 2015.

FSA may identify Title IV schools at risk of unexpected or abrupt closure by reviewing financial statements and other fiscal information, such as 13-week cash projections or liquidity measures, as well as the results of compliance audits, borrower complaints,<sup>7</sup> accreditor findings, and news articles. FSA uses a school's fiscal information to assess the school's overall risk and monitor the school's financial condition over time. For a limited number of schools, mostly publicly traded proprietary schools (publicly traded schools),<sup>8</sup> FSA has access to current fiscal information, such as quarterly financial data, and can watch for emerging trends or other issues that indicate potential future financial trouble. Current fiscal information for publicly traded schools is made available to FSA and the public through filings with the U.S. Securities and Exchange Commission on a quarterly basis (Form 10-Q) or when required (Form 8-K), and to FSA through a commercial, Web-based platform that it subscribes to.<sup>9</sup> The fiscal information contained in this platform includes financial statement data and other useful information, such as a probability of default measure (updated daily), financial ratios (updated quarterly), and credit model scores (updated annually). For most schools, FSA has relied almost exclusively on audited financial information reported in schools' annual financial statements to assess their compliance with financial responsibility requirements and apply sanctions when warranted. Attachment 2 provides a summary of key monitoring activities that FSA performs for each ownership type (proprietary, private nonprofit, and public).

When a school violates the law or regulations governing the Title IV programs, its program participation agreement, or any agreement made under the law or regulations, FSA has recourse under applicable Federal regulations. FSA can impose sanctions (34 C.F.R. Section 668 Subpart G) or request an LOC (34 C.F.R. Section 668 Subpart L). Sanctions include emergency actions, fines, limitations (such as enrollment restrictions or Title IV funding delays), suspensions, and terminations. If FSA has concerns about a school that has not violated applicable laws or regulations (such as the financial responsibility standards) but that may be at risk of unexpected or abrupt closure, its options for mitigating this risk are generally limited to changing the school's funding method from advance payment to heightened cash monitoring 1

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<sup>7</sup> On July 1, 2016, the Department launched the FSA Feedback System, an online portal that allows borrowers and others to submit complaints, provide feedback, and report suspicious activity regarding their experience with the Title IV programs.

<sup>8</sup> Publicly traded schools comprise about 3 percent of all schools that FSA is required to monitor.

<sup>9</sup> The platform generally does not include information for privately held proprietary schools or private nonprofit schools.

(HCM1) or HCM2<sup>10</sup> and/or reaching an agreement with the school on the type and frequency of additional information that must be reported to address FSA's concerns. If the school refuses to provide this additional information or if FSA and the school are unable to agree on the additional information to be reported, FSA can change the school's funding method from advance payment to HCM1 or HCM2. FSA has also worked to mitigate the potential harm to students and taxpayers by working with States and accreditors to provide students with teach-out facilities and by facilitating the sale of schools at risk of closure.

### **Closure of Corinthian Schools**

Corinthian was formed in 1995 and operated as one of the largest for-profit education companies in the United States before its closure in April 2015. Corinthian operated schools under three brands: Everest, WyoTech, and Heald. At its peak during 2013, Corinthian had more than 81,000 students enrolled at more than 100 campuses. In June 2014, FSA placed Corinthian on HCM1 and imposed a 21-day disbursement delay on Title IV funds because the company did not timely provide information supporting its placement rates that FSA had requested in January 2014. According to the former Chief of Staff for the Department's Office of the Under Secretary (OUS), Corinthian officials expressed concern that a 21-day disbursement delay would result in an almost immediate shut down of its operations, which at that time consisted of about 72,000 students and 97 campuses.

According to OUS's former Chief of Staff, the Department executed an operating agreement with Corinthian (effective July 8, 2014) to assist the company with an orderly closeout or sale of its schools. In February 2015, Corinthian sold 53 campuses, which enrolled about 33,000 students, to the Zenith Education Group, a subsidiary of the Educational Credit Management Corporation Group, Inc. On April 27, 2015, Corinthian abruptly shut down its remaining 30 campuses (which enrolled about 16,000 students at that time) because it had become apparent to Corinthian officials that these campuses could not be sold due to pending Federal and State investigations.

According to an FSA Program Compliance data analyst, closures have historically been at smaller schools with relatively few students. However, Corinthian's closure showed that even large publicly traded schools can unexpectedly or abruptly close and a large number of students can be adversely affected as a result. Potential harm to students when a school unexpectedly or abruptly closes includes students being displaced from their educational programs, having credits that they cannot transfer to another school, having student loan debt without obtaining a degree or certificate, and possibly not receiving a student loan discharge. Students wanting to have their student loans discharged generally have two options: request closed school debt relief under Section 437(c)(1) of the HEA (an option for students meeting certain requirements when a closure occurs), or make a borrower defense to repayment claim under Section 455(h) of the HEA and 34 C.F.R. Section 685.206(c). A borrower defense claim is an option for students who believe their school committed fraud or otherwise violated applicable State law related to their loans or the educational services that they paid for, regardless of whether the school closed. As of October 2016, the Department reported that it had approved student loan discharges (through

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<sup>10</sup> Under HCM1, a school draws down funds from the Department after it makes disbursements to eligible students from institutional funds and submits disbursement records to the Department's Common Origination and Disbursement system. Under HCM2, a school makes disbursements to students using its own institutional funds and must submit a Reimbursement Payment Request to the Department for those funds.

borrower defense claims or closed school debt relief loan discharges) totaling more than \$350 million for former Corinthian students.

### **New Borrower Defense Regulations**

In November 2016, the Department published new regulations, referred to as the “borrower defense regulations” in the Federal Register, which established a new standard and process for determining whether borrowers have a basis for not repaying their loans based on an act or omission of the school (34 C.F.R. Sections 668.71 and 685.222). The regulations also revised the financial responsibility standards (34 C.F.R. Sections 668.171 and 668.175) and added financial protection disclosure requirements (34 C.F.R. Section 668.41).<sup>11</sup> The Department stated in the preamble to the notice of proposed rulemaking related to the regulations that, based on the Department’s experience with Corinthian, it concluded that “regulations must be revised to better identify signs, and to augment the Department’s tools for detection, of impending financial difficulties that could be taken into account and that would have required Corinthian to provide financial protection.” The new borrower defense regulations, which become effective July 1, 2017, include additional events and conditions that could trigger a requirement that a school provide financial protection to the Department. Some triggers will automatically require a school to provide financial protection (automatic triggers), while others may require a school to provide financial protection, depending on the Department’s review and analysis (discretionary triggers). The Department noted that each trigger reflects a new financial obligation already incurred and not yet reflected in the school’s composite score, or a new financial risk that is realistically imminent, whether or not yet recognized in the audited financial statements. Under the new regulations, schools generally must notify the Department of any event or condition identified as a trigger no later than 10 days after the event or condition occurs.

The new regulations also provide for FSA to calculate a school’s composite score more frequently than annually if certain conditions are met. Specifically, FSA will regularly recalculate a school’s composite score if that school is subject to one or more of the following actions or triggering events: (1) a school is required to pay debt or incur any liability related to borrower defense-related lawsuits or other litigation, (2) a school is being sued in an action brought by a Federal or State authority for financial relief on claims related to the making of the Direct Loan for enrollment at the school or the provision of educational services and the suit has been pending for 120 days, (3) a school is required by its accrediting agency to submit a teach-out plan covering the closing of the school or any of its branches or locations, (4) a school has gainful employment programs that could become ineligible based on its final debt-to-earnings rates for the next award year, or (5) an owner of a proprietary school with a composite score less than 1.5 withdraws equity by any means from the school.

The borrower defense regulations make it easier for FSA to obtain financial protection (LOC or set-aside)<sup>12</sup> from Title IV schools that may be at increased risk of potential closure. For example, under the new regulations, a school is not financially responsible and would thus be required to provide an LOC if FSA determined that the school does not derive at least 10 percent

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<sup>11</sup> Federal Register notice 81 FR 75926, published on November 1, 2016.

<sup>12</sup> Under the new regulations, if a school does not provide an LOC or financial protection acceptable to the Department within 45 days of the request, the Department will offset the amount of Title IV funds that the school is eligible to receive in a manner that ensures that, within 9 months, the total offset amount (set-aside) equals the amount of financial protection that the school otherwise would have provided.

of its revenue from non-Title IV sources, its two most recent official cohort default rates are 30 percent or greater, or its recalculated composite score is less than 1.0 (automatic triggers). In addition, a school may not be considered financially responsible if there is a significant fluctuation between award years in the amount of Direct Loan and Pell Grant funds that the school received or if the school fails a financial stress test developed or adopted by the Department (discretionary triggers).<sup>13</sup> Furthermore, under the new regulations, schools required to provide financial protection to the Department must disclose information about that financial protection to enrolled and prospective students.

FSA may also develop or adopt a financial stress test that will be used to evaluate whether a school “has sufficient capital to absorb losses that may be incurred as a result of adverse conditions and continue to meet its financial obligations to the Secretary [of Education] and students.” FSA had not developed or adopted the financial stress test as of the date of our draft report.

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## AUDIT RESULTS

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FSA has processes, including newer processes that were adopted in response to the Corinthian closure, as well as the new borrower defense regulations that can help FSA identify Title IV schools at risk of unexpected or abrupt closure and mitigate the potential harm to students and taxpayers. However, FSA could do more to protect students and taxpayers from these types of school closures. Specifically, FSA needs to improve its processes for reviewing a school’s composite score calculation and any related composite score appeal made by a school, and implement controls to prevent schools from manipulating composite scores to avoid sanctions or increased oversight by FSA. Unexpected or abrupt school closures can have significant adverse effects on large numbers of students, including potentially being displaced from their educational program before completion, having credits that cannot transfer to another school, incurring significant student loan debt without obtaining a degree or certificate, and significantly diminished job prospects. School closures can adversely impact students’ job prospects because the students’ education may end without a degree and employers may question the quality of the educational programs that the students were enrolled in. Taxpayers are also adversely affected when these closures result in significant volume of loan discharges. As of October 2016, the Department reported that it had approved more than \$350 million in loan discharges for students who had attended a Corinthian school.

FSA’s policy is to follow applicable Federal regulations when requesting and obtaining LOCs from schools. We performed testing on a sample of schools that had a failing composite score (did not meet financial responsibility standards) to determine whether FSA requested and obtained proper LOCs from these schools. Each school’s LOC amount should have been at least 10 percent of the total Title IV funds received by the school during their most recently completed fiscal year, as required by 34 C.F.R. Section 668.175(f)(2)(i). We tested 30 of 203 schools with failing composite scores during AY 2013–2014 and determined that FSA requested LOCs from

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<sup>13</sup> The regulations include additional automatic and discretionary triggers not described above such as SEC actions and violation of loan provisions.

all schools where one was warranted. FSA obtained all but one<sup>14</sup> of the LOCs that it requested and the LOC amounts obtained by schools met or exceeded the minimum amount (10 percent) established under Federal regulation. The results from our testing pertain only to the schools included in our review and cannot be projected to the entire universe of schools with failing composite scores. See the Objective, Scope and Methodology section of the report for information about our sampling methodology.

We provided a draft of this report to FSA for review and comment. In its comments, FSA did not explicitly state whether it agreed with the finding or Recommendation 1.1. FSA stated that its procedures already established a timeframe for resolving financial statements and requesting a LOC, if needed, which we had recommended in Recommendation 1.1. We summarized FSA's comments to Recommendation 1.1 at the end of the finding and provided our response. FSA agreed with Recommendations 1.2 and 1.3 and stated it will revise its "Financial Analysis Procedures" accordingly. FSA also provided one technical comment to the draft report; we revised the report based on that comment. With the exception of this technical change, we did not make any changes to the finding and recommendations based on FSA's comments. We included the full text of FSA's comments as Attachment 4 to this report.

### **FINDING – FSA Adopted Additional Tools and Processes in Response to the Corinthian Closure but Further Improvements are Needed**

FSA adopted and implemented new tools and processes in response to the Corinthian closure, which began in July 2014 and ended in April 2015. Significant actions taken by FSA include:

- requiring multiregional corporations with zone or failing composite scores to submit 13-week cash projections every 2 weeks and monthly student enrollment information to FSA (*effective May 2015*);
- participating in ongoing efforts led by the Department's Office of Postsecondary Education to enhance the information sharing between the Department and school accrediting agencies (*efforts began in November 2015*); and
- creating an Enforcement Office responsible for investigating allegations and complaints made against schools, such as schools misrepresenting completion rates or placement rates or other recruiting violations (*established in February 2016; became operational in September 2016*).

Although not in direct response to the Corinthian closure, FSA also created the Multi-Regional and Foreign Schools Participation Division, a division within Program Compliance (and part of School Eligibility) that is responsible for monitoring the financial condition of schools in these categories (*established in July 2014; became operational in November 2014*).<sup>15</sup> FSA also subscribed to a commercial, Web-based platform that provides current and longer term fiscal and other information about publicly traded schools that FSA financial analysts and case managers can use for monitoring (*subscribed in January 2014; used by financial analysts and case*

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<sup>14</sup> Because the school closed down shortly after FSA requested the LOC, we did not consider this a failure to obtain the LOC.

<sup>15</sup> As of March 2016, there were 42 multiregional corporations that owned and operated more than 250 schools. The schools owned by these 42 corporations were all proprietary (for profit). Fifteen of the 42 corporations were publicly traded.



*managers beginning in November 2014*). In addition, in response to recommendations in a January 2015 report issued by the U.S. Government Accountability Office,<sup>16</sup> FSA incorporated adverse actions by accrediting agencies into its annual risk assessment used to select schools for program reviews (*effective October 2015*). As discussed in the Background section, FSA must determine whether a school is financially responsible, in part meaning the school has a composite score of at least 1.5.<sup>17</sup> A school with a composite score below 1.0 (failing composite score) must provide FSA with an irrevocable LOC for an amount determined by FSA that equals at least 10 percent of the Title IV funds received by the school during its most recently completed fiscal year.<sup>18</sup> According to the School Eligibility director, LOC decisions are discussed internally and made collectively as a group, which may or may not include the director. If the LOC being requested equals or exceeds a certain dollar threshold (currently \$7 million) or percentage regardless of dollar threshold (50 percent), the LOC request must be approved by the School Eligibility director.

Students and taxpayers both rely on FSA to have sufficient mechanisms to ensure that Title IV schools are fiscally and operationally sound. Students expect to receive a high quality education that provides the knowledge, skills, and tools to succeed once they join the workforce. Students also need assurance that the school they choose to attend will not abruptly shut down while they are completing their academic programs. Taxpayer funds made available to students in the form of grants or loans represent a substantial investment in their education. There is an expectation that schools will provide the education and training that will lead to students contributing to local, State, and national economies. When Title IV schools unexpectedly or abruptly close, liabilities that include the costs of discharged student loans are established against the closed schools. The unpaid liabilities from those closed schools are ultimately covered by the taxpayers.

Even though FSA has adopted new tools and processes in response to the Corinthian closure, lessons from that experience indicate that additional improvements are needed to better protect students and taxpayers. Specifically, FSA needs to enhance its policies and procedures to help ensure timely and appropriate action is taken to resolve schools' composite score appeals and implement controls to prevent schools from manipulating their composite scores to avoid FSA sanctions or increased oversight.

### **FSA Needs to Ensure Timely and Appropriate Action is Taken to Resolve Schools' Composite Score Appeals**

FSA did not timely request an LOC or promptly resolve Corinthian's FY 2011 composite score appeal, enabling Corinthian to avoid posting an LOC with FSA even though one was warranted. FSA notified Corinthian that it had calculated a failing composite score for FY 2011 on February 16, 2012. Corinthian informally disputed FSA's composite score determination about a week after first being notified and provided information that it believed showed that it had not failed the composite score. In July 2012, more than 5 months after Corinthian had informally

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<sup>16</sup> "Education Should Strengthen Oversight of Schools and Accreditors" (GAO-15-59), January 22, 2015.

<sup>17</sup> If certain requirements are met, a school with a composite score below 1.5 may continue to participate in the Title IV programs for up to three consecutive years under either the *zone* alternative or *provisional certification* alternative (34 C.F.R. Section 668.175(d) and (f)).

<sup>18</sup> FSA has the discretion to request an LOC from a failing school for an amount that exceeds 10 percent, but it cannot request one that is less than 10 percent.

disputed the failing composite score, FSA notified Corinthian that its composite score was still being reviewed. During those 5 months, FSA did not communicate with Corinthian regarding the composite score issue. According to Corinthian's General Counsel, the school presumed that its composite score was no longer an issue because it had not heard back from FSA for several months. FSA did not issue a determination on Corinthian's FY 2011 composite score for more than 8 months (October 31, 2012). At that point, FSA notified Corinthian that it would need to post an LOC as required by 34 C.F.R. Section 668.175(c) and (f)(2)(i).

On November 2, 2012, Corinthian formally appealed FSA's October 31, 2012, determination that it had failed the composite score financial responsibility test for FY 2011. However, FSA did not make a final decision on Corinthian's appeal for another 9 months (August 16, 2013). This extended timeframe to reach a final decision on this matter can partially be attributed to the time it took two accounting experts (retained by Corinthian) and a public accounting firm (retained by FSA) to make observations on how Corinthian's goodwill impairment charge of \$203.6 million should be treated for composite score calculation purposes, as well as the time it took FSA to review the divergent observations of the accounting experts and make a final determination.<sup>19</sup> In total, about 18 months passed between the time that FSA first notified Corinthian that it had calculated a failing composite score for FY 2011 and FSA's final decision on Corinthian's appeal.

According to Corinthian, the goodwill impairment charge was nonrecurring and not indicative of the company's future operations. Corinthian's position, and that of the two accounting experts it retained, was that the goodwill impairment charge should not be included as an operating expense in the net income and primary reserve ratios that factored into the FY 2011 composite score calculation. However, the public accounting firm retained by FSA stated that

it appears that FAS-142 [Statement of Financial Accounting Standards No. 142] states that the only time that a goodwill impairment loss is recorded other than as an operating expense under the income from continuing operations is when the goodwill impairment is associated with a discontinued operation... [t]here does not appear to be language in the federal regulations that directly suggests to exclude goodwill impairment losses that are reported in Total Expenses and Income Before Taxes from the Composite Score calculation.

FSA ultimately decided to retain its original position that the goodwill impairment charge was not an extraordinary item and should be included in the composite score calculation.

According to the director of FSA's Multi-Regional and Foreign Schools Participation Division, the issues outlined in Corinthian's response to FSA's February 2012 determination that the school had failed its FY 2011 composite score required feedback from FSA's Performance Improvement and Procedures Service Group and the Department's Office of General Counsel. The director noted that the issues, most significant of which was the proper treatment of goodwill impairment expense, were complex and needed to be thoroughly researched before a final

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<sup>19</sup> The two accounting experts completed their analyses in November 2012, within 2 weeks of Corinthian being notified that it failed financial responsibility. FSA worked with the public accounting firm in December 2012 and January 2013 to define the scope of work for its analysis. The firm completed its analyses of the goodwill impairment charge in April 2013. FSA did not issue its final determination until August 2013, or more than 3 months after the firm completed its analyses.

decision was reached. According to the director, FSA took several months to research the issues and reach a decision because FSA had no prior history resolving these issues.

FSA's delay in requesting an LOC from Corinthian, combined with the extended timeframe it took FSA to resolve Corinthian's composite score appeal, allowed Corinthian to avoid posting an LOC for FY 2011 even though one was warranted. In resolving the appeal in August 2013, FSA did not require Corinthian to post an LOC for FY 2011 because it had determined that Corinthian had a passing composite score for FY 2012. However, as discussed in the next section of this finding, FSA later determined (in May 2015) that Corinthian did not actually have a passing composite score for FY 2012 either. See Attachment 3 for a timeline of key events regarding Corinthian's FY 2011 composite score.

According to Sections 2.20 and 2.21.2 of FSA's "Financial Analysis Procedures," when FSA determines that a school must provide an LOC to continue participating in the Title IV programs, it must both informally notify the school and send a formal letter. Although FSA informally notified Corinthian in February 2012 that it had failed financial responsibility due to a failing composite score for FY 2011, FSA did not send a formal letter requesting an LOC until October 2012. If FSA had sent the letter to Corinthian in early 2012, the accounting experts retained by Corinthian and the accounting firm retained by FSA likely would have been involved sooner and Corinthian's FY 2011 composite score appeal could have been resolved as many as 8 months earlier than it was. Students and taxpayers would have had greater protections in the event of an unexpected or abrupt closure if FSA had acted timely in enforcing the LOC requirements in early 2012 and Corinthian had provided an LOC.

As was the case with Corinthian, untimely LOC requests and resolution of appeals could allow additional schools to avoid posting an LOC with FSA altogether. LOCs protect Department and taxpayer dollars against loss and help mitigate the potential harm to students. When LOCs are not obtained when warranted, taxpayers are exposed to the risk of significant loan discharges and potential harm to students increases. LOCs provide some assurance that the school has the money to pay required refunds to students or provide teach-out facilities in the event of a closure.

### **FSA Needs to Implement Controls to Prevent Schools From Manipulating Composite Scores**

In FYs 2011, 2012, and 2013, Corinthian took out short-term loans of about \$43 million, \$58 million, and \$86 million, respectively. In a May 11, 2015, letter to Corinthian, FSA concluded that Corinthian only borrowed those funds to increase its composite scores to a passing level in FYs 2011, 2012, and 2013, and thus avoid violating one of its bank's debt covenants (a composite score below 1.5 would have constituted a debt covenant violation). Specifically, Corinthian borrowed funds from a credit facility shortly before each of the above fiscal years ended. It reported the borrowed funds as long-term debt on its audited financial statements in part because the debt was structured to be repaid over a period greater than 12 months. Corinthian included the borrowed funds as long-term debt when calculating its composite scores, but paid off the loans almost immediately after each fiscal year ended. Long-term debt is intended to represent an investment in an institution's property, plant, and equipment<sup>20</sup> and increases a school's composite score because it acts as an offset against fixed

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<sup>20</sup> Under Federal regulation, the amount of long-term debt that may be included in the primary reserve ratio is limited to the "amount of net property, plant and equipment" (34 C.F.R. 668 Subpart L – Appendix A).

assets that are excluded from the primary reserve ratio calculation. Corinthian's actions resulted in an overstatement of the school's actual adjusted equity.<sup>21</sup> FSA became aware of Corinthian's use of short-term loans to inflate its FY 2011 composite score only because Corinthian referenced the short-term loans on a slide for its 4th Quarter FY 2011 shareholder presentation. An FSA review of Corinthian's FY 2011 audited financial statements would not have identified this manipulation based on FSA's "Financial Analysis Procedures" in place at the time (October 2010 version) nor would FSA detect this type of manipulation based on its current "Financial Analysis Procedures" (November 2012 version, updated through June 2013). For FSA to detect this type of manipulation, it would need transaction level financial information from schools. Schools generally do not have to report this information in their audited financial statements or notes to the financial statements, and FSA does not currently request this information when calculating a school's composite score. Under Section 487(a)(3) of the HEA, FSA can request underlying financial information from schools as part of its oversight responsibilities. This includes situations when improper financial manipulation may have occurred to avoid FSA sanctions or increased oversight. For example, schools with composite scores at or slightly above 1.0 (minimum *zone* score) might have manipulated their composite scores to avoid having to post an LOC. Similarly, schools with composite scores at or slightly above 1.5 (minimum *passing* score) may have manipulated their composite scores to avoid increased FSA oversight.

FSA viewed Corinthian's FY 2011 composite score manipulation as a one-time event and did not review the school's underlying financial information for FYs 2012 and 2013 to ensure that the practice did not continue. However, FSA's view was incorrect because the manipulation was not a one-time event. FSA's "Financial Analysis Procedures" require financial analysts to document the results of their analysis of a school's financial information in the Department's EZ-Audit system and Postsecondary Education Participants System, which would include documenting important information or notes related to the calculation of a school's composite score. However, the procedures do not require financial analysts to review prior year notes in EZ-Audit or Postsecondary Education Participants System for information that could highlight concerns or potential issues related to a school's composite score. FSA has discussed adding such a requirement but has not done so.

The financial analyst responsible for reviewing Corinthian's FY 2011 financial statements documented pertinent information about Corinthian's composite score manipulation for FY 2011. If FSA's procedures had included a specific requirement for financial analysts to review prior year notes, FSA might have analyzed Corinthian's short-term borrowings more closely in FYs 2012 and 2013 and might have determined that Corinthian continued to manipulate its composite scores during those years by improperly including funds from short-term loans in its total long-term debt. If FSA had identified the composite score manipulation during its initial review of Corinthian's FY 2012 composite score, it would have calculated a zone composite score of 1.2 instead of a passing score of 1.5.<sup>22</sup> According to 34 C.F.R. Section 668.175(d)(1), initial participation under the "zone" alternative is restricted to schools whose previous composite score was 1.5 or higher (passing) and continued participation

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<sup>21</sup> The primary reserve ratio is equal to a school's adjusted equity divided by total expenses. Adjusted equity is calculated as follows: (total owner's equity) - (intangible assets) - (unsecured related-party receivables) - (net property, plant and equipment) + (long-term debt) + (post-employment and retirement liabilities). Thus, an increase in long-term debt will increase the adjusted equity total.

<sup>22</sup> In a May 11, 2015, letter to Corinthian, FSA notified the school that it had revised the school's FY 2012 composite score from 1.5 to 1.2 and calculated a composite score of 1.2 for FY 2013.

under this alternative for a total of 3 consecutive years is restricted to schools whose previous composite score was in the range of 1.0 to 1.4). Because Corinthian's FY 2011 composite score was failing (0.9), Corinthian would not have been eligible to participate under the zone alternative in FYs 2012 and 2013 and FSA would not have rescinded its LOC demand based on the school's FY 2011 composite score.

When FSA's procedures do not require financial analysts and case managers to perform key activities, such as reviewing pertinent FSA financial analyst notes about a school's composite score from the prior year or reviewing underlying financial information when warranted as part of their composite score analysis, there is a greater risk that a school can manipulate its composite score without detection. As a result, schools with failing composite scores may continue to participate in the Title IV programs without restrictions despite being ineligible to participate, and they may avoid posting LOCs that they otherwise would have had to post. When schools with failing composite scores are not properly identified, taxpayer funds are at greater risk of loss and students are at greater risk of harm. Taxpayers bear the financial burden when student loan discharges amount to hundreds of millions of dollars as a result of unexpected or abrupt school closures like Corinthian. Potential harm to students when a school unexpectedly or abruptly closes includes being displaced from their educational program, having nontransferable credits, having debt without a degree or certificate, and failing to qualify for a student loan discharge.

## **Recommendations**

We recommend that the Chief Operating Officer for FSA—

- 1.1 To ensure that composite score appeals are resolved timely, establish a standard timeframe under which applicable FSA personnel must send formal letters to all schools that are required to provide an LOC to continue participating in the Title IV programs (for example, the formal letter must be sent within a specified number of days of the initial composite score determination date).
- 1.2 To ensure that schools are not manipulating their composite scores to avoid FSA sanctions or increased oversight, identify common ways that a school could manipulate its composite score, and amend FSA's "Financial Analysis Procedures" to include a requirement that financial analysts obtain and review detailed financial information for schools that FSA determines are at risk of manipulating their composite scores.
- 1.3 To ensure that FSA financial analysts are aware of any school composite score issues from the prior year, amend FSA's "Financial Analysis Procedures" to include a requirement that financial analysts review prior year notes in EZ-Audit and the Postsecondary Education Participants System for information that could help them during their review of a school's current year composite score

## **FSA Comments**

FSA did not explicitly state whether it agreed with Recommendation 1.1 but stated that its procedures currently require analysts to resolve a financial statement and send the initial LOC request to schools, if needed, within 90 days. FSA also stated that it agrees with a recommendation for establishing a timeframe under which applicable FSA personnel must

respond in writing to schools that have appealed FSA's LOC request. FSA noted that the Corinthian case was an anomaly in that it was a very complex issue involving a number of offices internal and external to the Department, and as a result, it took more time to resolve the case. FSA agreed with Recommendations 1.2 and 1.3.

### **OIG Response**

We acknowledge that FSA has procedures requiring its analysts to resolve a school's financial statements within 90 days.<sup>23</sup> However, this 90-day resolution period does not include a timeframe for sending LOC request letters (formal LOC demand) to schools or granting administrative stays.<sup>24</sup> FSA's procedures do not establish a specific timeframe in which the formal LOC demand must be sent to a school. FSA should revise its procedures by establishing a specific timeframe, such as 5 business days, in which formal LOC demands must be sent to schools once the financial statements have been resolved.

For Corinthian, FSA did not send the formal LOC demand letter until 258 days after the school's FY 2011 financial statements were initially resolved, which unnecessarily exposed a substantial amount of taxpayer funds to increased risk. If a requirement for promptly issuing formal LOC demands to schools had been in place in February 2012, Corinthian's FY 2011 composite score appeal could have been resolved many months earlier.

Issuing a formal LOC demand starts the clock on certain actions schools must take, including the time a school has to formally appeal a failing composite score (30 days after receiving the LOC demand) or post an LOC (75 days after receiving the LOC demand). Requiring that formal LOC demands be issued promptly after determining a school has failed its composite score will help ensure that appeals are made timely, disagreements are handled through a formal appeals process (instead of informally with no timeframes for resolution), and appeals are resolved promptly. In cases where a school does not appeal, adding specificity to the procedures will help ensure that LOCs are posted within required timeframes so that Federal funds are protected. Recommendation 1.1 is intended to ensure that FSA promptly issues an LOC demand once it determines that a school has failed the composite score financial responsibility test, which in turn prevents significant delays from occurring that could allow schools such as Corinthian to avoid posting an LOC altogether.

FSA also stated that it agrees with a recommendation for establishing a timeframe under which applicable FSA personnel must respond in writing to schools that have appealed FSA's LOC request. Even though we did not make such a recommendation, this type of policy would also be beneficial as it should help ensure timely resolution of formal LOC demand appeals.

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<sup>23</sup> A financial statement is considered "resolved" once the analyst has completed his/her assessment of a school's financial statements and the results have been approved by the Compliance Manager. The analyst's results may, among other things, require a school to post an LOC if the analyst determines that the school failed the composite score component of the financial responsibility requirements.

<sup>24</sup> An administrative stay is a temporary suspension of the 90-day resolution period which may be granted when certain conditions exist that preclude the analyst from resolving a school's financial statements within that timeframe. Reasons for granting an administrative stay include that there are ongoing litigation or OIG investigations involving the school, the school is asked to provide additional information to FSA, or the analyst needs to perform additional research to complete the assessment.

FSA's proposed actions in response to Recommendations 1.2 and 1.3, if implemented, are responsive to the recommendations. With the exception of one technical change, we did not make any changes to the finding or recommendations based on FSA's comments.

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## **OTHER MATTER**

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If the new borrower defense regulations are enforced, FSA should receive important, timely information from publicly traded, private for-profit, and private nonprofit schools that experience triggering events or conditions. Collecting and analyzing this information will improve FSA's processes for identifying Title IV schools at risk of unexpected or abrupt closure. Enforcement of the new regulations will also improve FSA's processes for mitigating potential harm to students and taxpayers by giving FSA the ability to obtain financial protection from schools based on information that is broader and more current than information schools provide in their annual audited financial statements.

Under the new regulations, FSA has an opportunity to develop or adopt a financial stress test that will be used to evaluate a school's ability (capital position) to absorb losses that may be incurred as a result of adverse conditions and continue to meet its financial obligations (34 C.F.R. Section 668.171(g)(3), effective July 1, 2017). If properly designed, the financial stress test could be a useful tool for FSA to evaluate a school's capital position.

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## **OBJECTIVE, SCOPE, AND METHODOLOGY**

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The objective of our audit was to assess FSA's processes for identifying Title IV schools at risk of unplanned (that is, unexpected or abrupt) closure and mitigating the potential harm to students and taxpayers. A significant portion of our review focused on FSA's monitoring of Corinthian because the recent school closure provided an actual example of how FSA carried out monitoring of an at-risk school. The scope of our review was limited to the processes that FSA had in place from January 2012 through July 2016. We selected this time period because it would allow us to see how FSA identified and monitored at-risk Title IV schools in the years leading up to the Corinthian closure and how FSA's processes have changed since the closure. The processes covered under our review generally included FSA activities in the following areas: annual risk assessments of Title IV schools; program and financial reviews of Title IV schools; and actions taken to help prevent unexpected or abrupt school closures and/or mitigate the potential harm to students and taxpayers, such as obtaining an LOC, changing a school's funding method, or facilitating the sale of a school or teach out of a school's programs.

To obtain background information about FSA and its operations, we reviewed—

- Organizational charts, list of key personnel, and information from a Department Web site (ed.gov) that described the roles and responsibilities of the various units within FSA,

including Program Compliance, Customer Experience, Risk Management, and Business Operations.

- Student loan debt and Title IV funding reports from Department Web sites, including the “Federal Student Aid Portfolio Summary” with information through September 30, 2015 (studentaid.ed.gov) and “AY 2014–2015 Funding Data Summary Report” (pcnet.ed.gov). We also reviewed Title IV funding information for AYs 2010–2011 through 2013–2014.
- Program review information by school ownership type, including the number of program reviews that FSA started and completed from October 2011 through September 2015.
- Historical information about school closures, composite scores, cohort default rates, and graduation rates from Department Web sites, including the list of school closures from August 1984 through January 2016 (ed.gov), composite scores for AYs 2010–2011 to 2013–2014 (studentaid.ed.gov), official 3-year cohort default rates for FYs 2010, 2011, and 2012 (ed.gov), and graduation rates for 1996–2007 cohorts of first-time, full-time bachelor's degree-seeking students at 4-year schools (nces.ed.gov).
- Prior OIG products, including two inspection reports (“Review of Federal Student Aid’s Monitoring of Financial Responsibility,” I13K0001, March 2011; and “Review of Federal Student Aid’s Plans for School Closures by a For-Profit Entity,” I13N0001, February 2014), an audit report (“Federal Student Aid’s Oversight of Schools Participating in the Title IV Programs,” A03L0001, September 2015), and a memorandum from the Inspector General to the Department’s Secretary (“Proprietary School Risk Factors,” July 2014), which set forth the risk factors that the OIG believes could be used to monitor schools that are in financial distress or that are under investigation for potential misrepresentation.
- U.S. Government Accountability Office report, “Education Should Strengthen Oversight of Schools and Accreditors” (GAO-15-59), January 2015, which in part looked at how the Department used information on accretor sanctions to support its oversight efforts.
- FSA’s Strategic Plan for FYs 2012–2016, which describes FSA’s strategy for meeting specific goals and objectives, and relevant sections of the 2015–2016 FSA Handbook.

To achieve our audit objective, we interviewed FSA officials and staff working in Program Compliance (School Eligibility, Performance Improvement and Procedures Service Group), Customer Experience, Risk Management, Finance, Business Operations, and Office of the Chief Operating Officer (Policy Liaison and Implementation Staff, Enterprise Data Office). We also interviewed FSA’s Chief Enforcement Officer, who leads the Enforcement Office at FSA. We reviewed FSA’s written policies and procedures related to financial analysis, compliance audits, and program reviews to corroborate the testimonial evidence that we obtained during the interviews.<sup>25</sup> Through these interviews and reviews of FSA documents and written policies and procedures, we gained an understanding of FSA’s processes for identifying Title IV schools at risk of unexpected or abrupt closure and mitigating the potential harm to students and taxpayers, including processes that were adopted in response to the Corinthian closure. We also reviewed—

- FSA’s FY 2015 Compliance Initiative, which ranked schools by overall risk based on 10 factors and 4 multipliers and which FSA used to select schools for program review.

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<sup>25</sup> “Financial Analysis Procedures” (October 2010 version and November 2012 version, updated through June 2013), Multi-Regional and Foreign Schools Participation Division procedures (draft version as of March 2016), “Compliance Audit Procedures” (November 2012 version, updated through June 2014), and “Program Review Procedures” (November 2012 version, updated through July 2015).



- Relevant sections of the HEA and Federal regulations, particularly 34 C.F.R. Part 668 Subparts B (Standards for Participation in Title IV Programs), G (Fine, Limitation, Suspension and Termination Proceedings), and L (Financial Responsibility), which describe the standards that a school must meet to continue participating in the Title IV programs and FSA’s responsibility for monitoring and holding a Title IV school accountable when it does not meet those standards.
- Notice of Proposed Rulemaking on the Borrower Defense to Repayment Regulations, published in the Federal Register on June 16, 2016, at 81 FR 39330–39422.
- Federal Register notice 81 FR 75926, published on November 1, 2016.
- General information about LOCs, composite scores, and HCM1/HCM2 from a Department Web site (studentaid.ed.gov). We also reviewed the list of schools on HCM1/HCM2 as of March 2016 (obtained from studentaid.ed.gov).
- Description of a FSA case manager’s job responsibilities to gain an understanding of what case managers typically do and how their time is allocated to different activities, as well as the list of multiregional corporations assigned to each case manager. We also obtained and reviewed resumes for the financial analyst responsible for reviewing the audited financial statements for all 42 multiregional corporations and the 5 case managers working in the Multi-Regional and Foreign Schools Participation Division to understand their qualifications.
- The 13-week cash projections and monthly enrollment data for 8 of the 9 multiregional corporations with a failing or zone composite score that were required to report this information.<sup>26</sup> We reviewed cash projections and student enrollment rosters for each corporation to verify the implementation of FSA’s new policy requiring multiregional corporations with failing or zone composite scores to submit 13-week cash projections every 2 weeks and student enrollment information monthly.
- Agendas, minutes, and notes from internal FSA meetings, including School Eligibility’s weekly status meetings, bi-weekly financial analyst meetings, and monthly Multi-Regional and Foreign Schools Participation Division meetings.
- A May 2015 presentation prepared for the Secretary of Education, which provided information about large school closures and listed the levers and actions that the Department could take to help prevent or manage abrupt school closures.
- U.S. Government Accountability Office’s “Standards for Internal Control in the Federal Government” (1999 and 2014), which defines and provides examples of internal control activities that can help ensure that management directives and agency objectives are carried out in an effective and efficient manner.

To see how FSA’s processes were implemented for a school that recently closed, we obtained and reviewed documentation for the Corinthian closure. We reviewed an FSA-prepared timeline of key events beginning in February 2012 (when FSA first calculated a failing FY 2011 composite score for Corinthian) and ending in May 2015 (the month after Corinthian closed its remaining campuses), as well as the underlying documentation supporting these key events. We also reviewed email and other written correspondence between Department officials and Corinthian officials during this time period. Through interviews with FSA officials and review of an FSA-prepared case study<sup>27</sup> that identified lessons learned from the Corinthian closure, we

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<sup>26</sup> When we requested cash projection and enrollment data for review, one corporation had not yet submitted information to FSA. We determined that information for the other 8 corporations was sufficient to verify the existence and implementation of FSA’s new policy.

<sup>27</sup> The case study was part of the May 2015 presentation prepared for the Secretary of Education.

learned which Department actions were deemed ineffective and how FSA's processes have changed in response to the Corinthian closure. We also reviewed—

- The operating agreement between the Department and Corinthian, effective July 8, 2014, and its amendments, which the parties hoped would provide students with an opportunity to complete their educational programs without significant interruption. We interviewed Department officials from FSA, OUS, and the Office of General Counsel to gain an understanding of how the operating agreement originated and why the agreement did not prohibit Corinthian from enrolling new students.
- FSA financial analyst notes in the Department's Postsecondary Education Participants System and EZ-Audit systems regarding Corinthian's audited financial statements for FYs 2011, 2012, and 2013.
- A readiness plan for the Corinthian closure, which described the actions that FSA and Corinthian would need to perform to ensure an orderly closure of the Corinthian schools.
- A handout that FSA gave to displaced Corinthian students, providing information about how to transfer to another school, contact State agencies responsible for school licensing or oversight, and obtain student loan discharges, transcripts, and information from servicers.

### **Letter of Credit Testing**

We performed testing to determine whether FSA was (1) requesting and obtaining LOCs from Title IV schools with failing composite scores, and (2) obtaining LOCs in amounts that were at least 10 percent of the amount of Title IV funds received by the schools during their most recently completed fiscal year, as required by 34 C.F.R. Section 668.175(f)(2)(i). We selected a stratified random sample from schools that did not meet the financial responsibility standards due to a failing composite score.

We first defined our universe as the schools that had a failing composite score (0.9 or below) as listed in the Department report "Composite Scores for Private Non-Profit and Proprietary Institutions with Fiscal Years Ending between 7/1/2013 and 6/30/2014." There were 203 schools in our universe. We then organized the universe into two strata: (1) proprietary schools with a failing composite score (132 schools, or about 65 percent of the universe) and (2) private nonprofit schools with a failing composite score (71 schools, or about 35 percent of the universe). We reviewed a total sample size of 30 (about 15 percent of the universe) proportionately allocated across the two strata to determine if FSA was requesting and obtaining LOCs in amounts that are at least 10 percent of the Title IV funds received by the schools. We randomly selected 20 proprietary schools ( $20/132 = 15$  percent) and 10 private nonprofit schools ( $10/71 = 14$  percent) for testing. The results from our testing, which are covered in the Audit Results section of this report, pertain only to the schools included in our review and cannot be projected to the entire universe of schools with failing composite scores.

### **Data Reliability**

We relied on information contained in the Department report "Composite Scores for Private Non-Profit and Proprietary Institutions with Fiscal Years Ending between 7/1/2013 and 6/30/2014" to define the universe of failing schools from which random samples could be drawn for our LOC testing. The composite score information contained in this report was pulled from the Department's EZ-Audit system. To test the completeness of the data in the Department's

composite score report, we compared the total number of proprietary and private nonprofit schools included in the Department's composite score report to the total number of proprietary and private nonprofit schools included in FSA's AY 2013–2014 Funding Data Summary Report. We concluded that the data was complete for purposes of our audit. To verify that the composite scores stored in EZ-Audit were properly listed in the report, we compared the composite scores listed in the report for the 30 sample schools to the composite scores stored in EZ-Audit. We determined that the composite scores matched for all 30 schools, without exception. From our sample testing, we also determined that LOCs were obtained from all but one of the sample schools where one was warranted, indicating the schools' acknowledgement that they had a failing composite score and needed to provide an LOC. Thus, we concluded that the composite score information contained in the report and in the Department's EZ-Audit system was sufficiently reliable for purposes of our audit.

### **Internal Controls**

We gained an understanding of FSA's internal controls over its processes for identifying at-risk Title IV schools and mitigating the potential harm to students and taxpayers. We reviewed documentary evidence to corroborate the testimonial evidence that we obtained from FSA officials regarding FSA's processes. To assess FSA's control activity of requiring 13-week cash projections and student enrollment information from multiregional corporations with zone or failing composite scores, we reviewed cash projections and student enrollment data for 8 of the 9 multiregional corporations subject to such reporting requirements. We determined that FSA was implementing the control activity for the 8 multiregional corporations, without exception. To corroborate testimonial evidence (obtained from School Eligibility officials) that FSA LOC decisions are made as a group (instead of decisions being made by one person) and that higher dollar or percentage LOCs must be approved by the School Eligibility director, we reviewed FSA's "Financial Analysis Procedures" and FSA meeting agendas, minutes, and notes. We determined that FSA's "Financial Analysis Procedures" contain these requirements and found evidence in the FSA meeting agendas, minutes, and notes that we reviewed to support that FSA discusses LOC decisions internally as a group before making final LOC decisions, which collectively corroborated the internal LOC review and approval process described to us.

We held an entrance conference with FSA officials and performed initial audit work at FSA's offices in Washington, D.C., in December 2015. We performed additional audit work at our regional office in Sacramento, CA, from December 2015 to December 2016. We held an exit briefing with FSA officials on December 6, 2016.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objective.

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## ADMINISTRATIVE MATTERS

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Corrective actions proposed (resolution phase) and implemented (closure phase) by your office will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System (AARTS). The Department's policy requires that you develop a final corrective action plan (CAP) for our review in the automated system within 30 calendar days of the issuance of this report. The CAP should set forth the specific action items, and targeted completion dates, necessary to implement final corrective actions on the findings and recommendations contained in this final audit report. An electronic copy of this report has been provided to your audit liaison officers.

In accordance with the Inspector General Act of 1978, as amended, the Office of Inspector General is required to report to Congress twice a year on the audits that remain unresolved after six months from the date of issuance.

Statements that managerial practices need improvements, 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 the appropriate Department of Education officials.

In accordance with the Freedom of Information Act (5 U.S.C. §552), reports issued by the Office of Inspector General are available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

We appreciate the cooperation given us during this review. If you have any questions, please call Raymond Hendren at (916) 930-2399.

Sincerely,

/s/

Patrick J. Howard  
Assistant Inspector General for Audit

Attachments

## **Attachment 1: Abbreviations, Acronyms, and Short Forms Used in this Report**

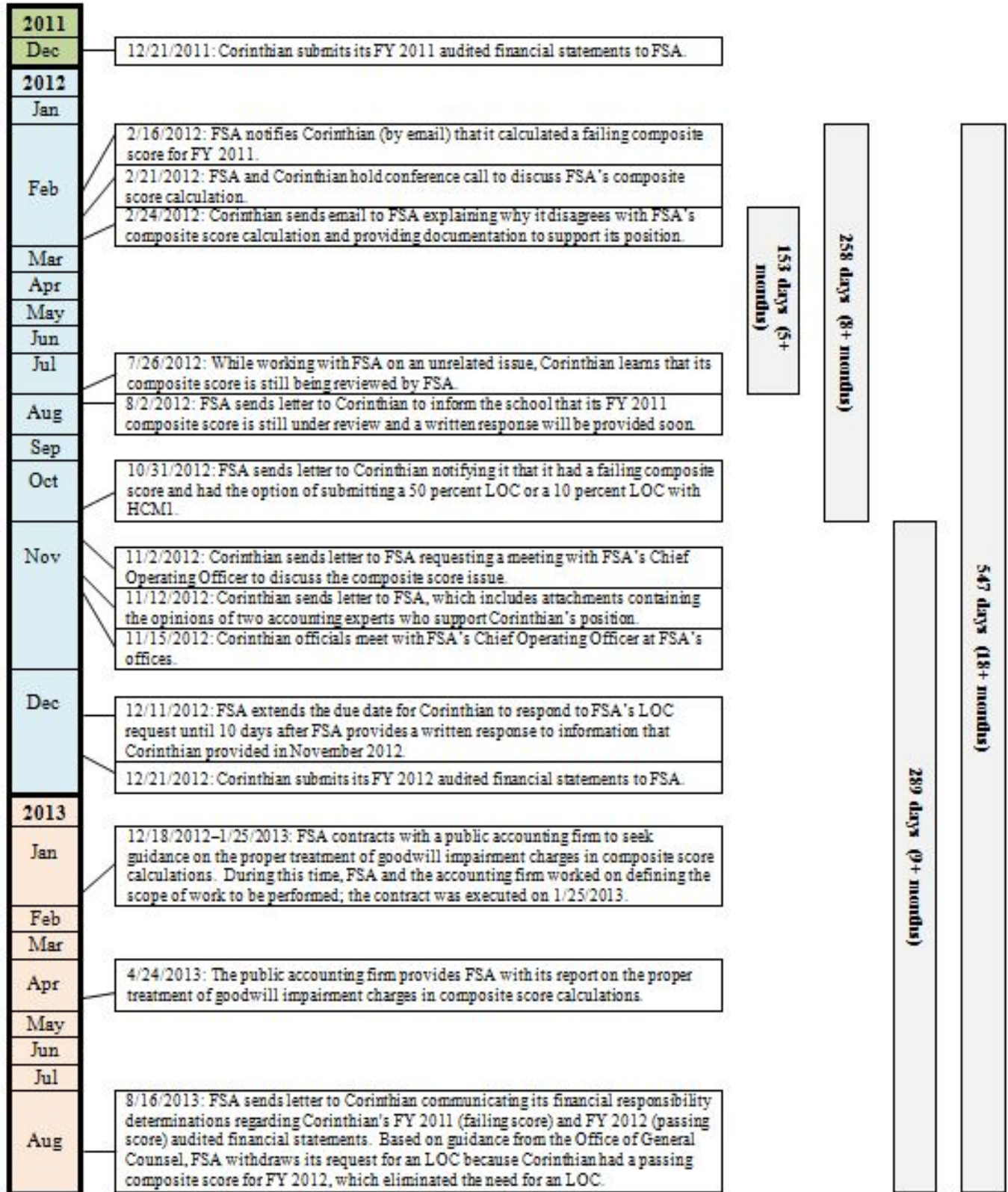
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AY	Federal Award Year
C.F.R.	Code of Federal Regulations
Corinthian	Corinthian Colleges, Inc.
Department	U.S. Department of Education
FSA	Federal Student Aid
FY	Fiscal Year
HCM1	Heightened Cash Monitoring 1
HCM2	Heightened Cash Monitoring 2
HEA	Higher Education Act of 1965, as Amended
LOC	Letter of Credit
OUS	Office of the Under Secretary
Private Nonprofit Schools	Schools Owned by Private Nonprofit Organizations
Privately held Proprietary Schools	Proprietary Schools Owned by Privately Held Corporations
Proprietary Schools	Schools Owned by For-Profit Corporations
Publicly traded Schools	Proprietary Schools Owned by Publicly Traded Corporations
School Eligibility	FSA's School Eligibility Service Group
Schools	Postsecondary Schools
Title IV	Title IV of the Higher Education Act of 1965, as Amended

## Attachment 2: Key FSA Monitoring Activities by School Ownership Type

Monitoring Activity	For-Profit			Private, Nonprofit	Public
	Multiregional School, Publicly Traded	Multiregional School, Privately Held	Privately Held School, Not Multiregional		
Prepare annual compliance initiative that ranks Title IV schools by risk.	X	X	X	X	X
Conduct program reviews.	X	X	X	X	X
Review schools' audited annual financial statements (if flagged in EZ-Audit or if a multiregional school).	X	X	X	X	X
Review school's annual compliance audit (if material compliance issues exist).	X	X	X	X	X
Discuss monitoring issues and information at FSA staff meetings.	X	X	X	X	X
Obtain list of campuses and student rosters (and their contact information) for schools FSA has reason to believe may close.	X	X	X	X	X
Obtain and review 13-week cash projections every 2 weeks and monthly student enrollment information for multiregional corporations with zone or failing composite scores.	X	X	n/a	n/a	n/a
Monitor financial and other information for publicly traded schools using a Web-based platform.	X	n/a	n/a	n/a	n/a

### Attachment 3: Timeline of Key Events Regarding Corinthian’s FY 2011 Composite Score



## Attachment 4: FSA's Comments on the Draft Report

### MEMORANDUM

**DATE:** January 12, 2017

**TO:** Raymond Hendren  
Regional Inspector General for Audit  
Sacramento Audit Region  
Office of Inspector General

**FROM:** James W. Runcie /s/  
Chief Operating Officer

**SUBJECT:** Response to Draft Audit Report:  
*Federal Student Aid's Processes for Identifying At-Risk Title IV Schools and Mitigating Potential Harm to Students and Taxpayers*  
Control No. ED-OIG/A09-Q0001

Thank you for the opportunity to comment on the Office of Inspector General's (OIG) draft audit report, "*Federal Student Aid's Processes for Identifying At-Risk Title IV Schools and Mitigating Potential Harm to Students and Taxpayers*," dated December 14, 2016. The purpose of the audit was to assess Federal Student Aid's (FSA) processes for identifying Title IV schools at risk of unplanned closure and mitigating the potential harm to students and taxpayers.

As noted in the draft report, FSA adopted and implemented significant new tools and processes to identify at-risk schools and mitigate potential student and taxpayer harm, including more frequent financial and enrollment reporting requirements for at-risk schools, enhanced information sharing, subscriptions to industry analyses for fiscal information about publicly-traded schools, and enhancements to the annual risk model used to select schools for program reviews. FSA has also created an Enforcement Office for investigating allegations and complaints against schools, as well as having created an office that is responsible for the monitoring of the financial condition of multi-regional and foreign schools. Also as noted in the draft report, the OIG determined that FSA, for the period audited, requested letters of credit (LOC) from all schools where one was warranted, received the requested LOCs (note: one school closed down shortly after FSA requested the LOC, so in this case, an LOC was not received), and the LOCs met or exceeded the amounts required by Federal regulation.

FSA's responses to the recommendations in the OIG's draft audit report follows.

### **FINDING — FSA Adopted Additional Tools and Processes in Response to the Corinthian Closure but Further Improvements are Needed**

**RECOMMENDATION 1.1** — To ensure that composite score appeals are resolved timely, establish a standard timeframe under which applicable FSA personnel must send formal letters to all schools that are required to provide an LOC to continue participating in the Title IV programs



(for example, the formal letter must be sent within a specified number of days of the initial composite score determination date).

**RESPONSE:**

FSA procedures currently include an established timeframe of 90 days for resolving a financial statement and sending the initial letter requesting an LOC if needed. FSA agrees with a recommendation for establishing a timeframe under which applicable FSA personnel must respond in writing to all schools that have submitted an appeal for submission of the LOC. FSA would like to note that the Corinthian case reviewed by the OIG was an anomaly in that it was a very complex issue that involved a number of offices internal and external to the Department, and as a result, more time was involved in resolving the case.

**RECOMMENDATION 1.2** — To ensure that schools are not manipulating their composite scores to avoid FSA sanctions or increased oversight, identify common ways that a school could manipulate its composite score, and amend FSA’s “Financial Analysis Procedures” to include a requirement that financial analysts obtain and review detailed financial information for schools that FSA determines are at risk of manipulating their composite scores.

**RESPONSE:**

FSA agrees with this recommendation and will identify common ways that a school could manipulate its composite score. FSA will update its “Financial Analysis Procedures” to reflect the additional information that the financial analysts must obtain and review to determine if a school may be manipulating their composite scores.

**RECOMMENDATION 1.3** — To ensure that FSA financial analysts are aware of any school composite score issues from the prior year, amend FSA’s “Financial Analysis Procedures” to include a requirement that financial analysts review prior year notes in EZ-Audit and the Postsecondary Education Participants System for information that could help them during their review of a school’s current year composite score.

**RESPONSE:**

FSA agrees with this recommendation. FSA’s “Financial Analysis Procedures” currently state that the financial analyst must review the last three years of financial statements submitted by the institution. FSA will revise the procedures to explicitly note that the financial analyst must also review prior year notes in EZ-Audit and the Postsecondary Education Participants System for relevant information.

Additionally, the draft report states that the Multi-Regional and Foreign Schools Participation Team was established in October 2012, the Team was actually established in July 2014.

Again, thank you for the opportunity to comment on the draft audit report. If you have questions about the response, please let us know.