Star Technical Institute's Upper Darby School's Compliance with the 90 Percent Rule

FINAL AUDIT REPORT

ED-OIG/A03H0009
August 2008

Our mission is to ensure equal access to education and to promote educational excellence throughout the nation.

U.S Department of Education
Office of Inspector General
Philadelphia, PA

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UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

Audit Services, Region III-Philadelphia

August 15, 2008

Karen Manin, President
Star Technical Institute
Centennial Center, Suite 101A
175 Cross Keys Road
Berlin, NJ 08009-9908

Dear Ms. Manin:

Enclosed is our final audit report, Control Number ED-OIG/A03H0009, entitled, "Star Technical Institute's Upper Darby School's Compliance with the 90 Percent Rule." This report incorporates the comments you provided in response to the draft report. If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Department of Education official, who will consider them before taking final Departmental action on this audit:

Lawrence Warder
Acting Chief Operating Officer
Federal Student Aid
U.S. Department of Education
Union Center Plaza, Room 112G1
830 First Street, N.E.
Washington, D.C., 20202

It is the policy of the U.S. Department of Education to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within 30 days would be appreciated.

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.

Sincerely,

/s/
Bernard Tadley
Regional Inspector General for Audit

Enclosure

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EXECUTIVE SUMMARY

The purpose of our audit was to determine whether Star Technical Institute's (STI) Upper Darby school complied with the 90 Percent Rule, Section 102(b)(1)(F) of the Higher Education Act of 1965, as amended (HEA), and had sufficient, reliable accounting records to support its 90 Percent Rule calculations for the fiscal years (FYs) ended December 31, 2003, 2004 and 2005.

Section 102(b)(1)(F) of the HEA requires that proprietary institutions derive at least 10 percent of their revenues from non-Title IV sources. Conversely, no more than 90 percent of total revenue could be derived from the Title IV programs. The institutional eligibility requirement is commonly referred to as the 90 Percent Rule. As specified in 34 Code of Federal Regulations (C.F.R.) § 600.5(d), a school must determine and certify its revenue percentages using the following formula for its latest complete fiscal year:

Title IV, HEA program funds the institution used to satisfy its students' tuition, fees, and other institutional charges to students

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The sum of revenues including title IV, HEA program funds generated by the institution from tuition, fees, and other institutional charges for students enrolled in eligible programs as defined in 34 CFR 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.

STI reported in the notes to its FY 2003, 2004 and 2005 audited financial statements that its Upper Darby school met the 90 Percent Rule with 89.35 percent, 89.48 percent, and 89.29 percent of its revenue from Title IV sources, respectively. We determined that STI's Upper Darby school did not comply with the 90 Percent Rule, did not have sufficient, reliable accounting records to support its 90 Percent Rule calculations, and that it received 96.16 percent, 94.67 percent, and 92.67 percent of its revenue from Title IV funds during those years, respectively.

We found that STI's Upper Darby school improperly –

- Included $202,925 and $105,447 in sales of written off accounts receivable sold to a related party as non-Title IV revenue in its FY 2003 and 2004 90 Percent Rule calculations, respectively;
- Included $70,925 of student payment revenue that was paid by the four shareholders of STI's parent corporation as non-Title IV revenue in its FY 2005 90 Percent Rule calculation;
- Excluded $48,900 and $54,200 in institutional fees from the numerator of its FY 2004 and 2005 90 Percent Rule calculations, respectively;
- Included $1,613 in tuition receipts for a student that attended its Roosevelt, PA school as non-Title IV revenue in its FY 2004 90 Percent Rule calculation; and

- Included $1,839 for a student's scheduled Sallie Mae disbursement that was never received as non-Title IV revenue in its FY 2005 90 Percent Rule calculation.

Institutions that fail to satisfy the 90 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. [34 C.F.R. § 600.40(a)(2)] Consequently, STI was ineligible to participate in the Title IV programs for the period January 1, 2004, through December 31, 2006.

We recommend that the Acting Chief Operating Officer for Federal Student Aid (FSA) –

- Initiate action under 34 C.F.R. § 668.86(a)(1) to terminate STI's Upper Darby school from participation in the Title IV programs.
- Require that STI's Upper Darby school return $9,830,436 in Federal Pell Grant program (Pell), Federal Supplemental Educational Opportunity Grant program (FSEOG), and Federal Direct Loan (Direct Loan) program funds to the U.S. Department of Education (the Department) that its Upper Darby school received from January 1, 2004, through December 31, 2006.
- Require STI's Upper Darby school to return all Title IV monies received after December 31, 2006, if the Secretary has not made a determination under 34 C.F.R. § 600.5(g) that the school demonstrated compliance with all eligibility requirements for at least the fiscal year ended December 31, 2006.

STI did not concur with most of the Finding and it did not concur with the recommendations. STI did concur with two of the exceptions identified in the Finding. We considered STI's comments; however, our Finding and recommendations remain unchanged. STI's comments are summarized at the end of each exception.

Except for information protected under the Privacy Act of 1974 (5 U.S.C. § 552a), the full text of STI's comments is included as an Enclosure to this report. Because of the voluminous nature of the attachments to STI's comments, we have not included them in the Enclosure. Copies of the attachments are available on request.

BACKGROUND

STI was founded in 1979 and is a proprietary institution operating in New Jersey, Pennsylvania, and Delaware. STI had three main campuses (each with its own OPE ID number) and four additional locations as follows –

- STI Stratford, New Jersey (main campus, OPE ID 02586900)
- STI Lakewood, New Jersey (additional location of Stratford, NJ)
- STI Dover, Delaware (additional location of Stratford, NJ)

- STI Upper Darby, Pennsylvania (main campus, OPE ID 02539900)
- STI Egg Harbor Township, New Jersey (additional location of Upper Darby, PA)

- STI North East Philadelphia, Pennsylvania (main campus, OPE ID 02615400)
- STI Edison, New Jersey (additional location of North East Philadelphia, PA)

STI was accredited by the Accrediting Commission of Career Schools and Colleges of Technology. STI's Upper Darby school was licensed by the Pennsylvania Department of Education State Board of Private Licensed Schools. The institution offered training in computers, allied health, business, and technology. STI is owned by Nerak Enterprises, Incorporated (Nerak), a New Jersey corporation.

STI's Upper Darby school received initial approval to participate in the Title IV programs in December 1987 and its current approval expires on December 31, 2008. STI's Upper Darby school participated in the following Title IV programs: Pell, FSEOG, and Direct Loan. During the period January 1, 2003 through December 31, 2005, STI's Upper Darby school received $9,694,084 in Title IV funds.

AUDIT RESULTS

Our audit disclosed that STI's Upper Darby school did not comply with the 90 Percent Rule, did not have sufficient, reliable accounting records to support its 90 Percent Rule calculations, and that it received 96.16 percent, 94.67 percent, and 92.67 percent of its revenue from Title IV funds during FYs 2003, 2004, and 2005, respectively. Therefore, STI was ineligible to participate in the Title IV programs.

STI did not concur with most of the Finding and it did not concur with the recommendations. STI did concur with two of the exceptions identified in the Finding.

Finding – Star Technical Institute's Upper Darby School Did Not Comply with the 90 Percent Rule

STI's Upper Darby school was ineligible to participate in the Title IV, Student Financial Assistance (SFA) programs from January 1, 2004, through December 31, 2006, because it received more than 90 percent of its revenue from Title IV sources during the FYs ended December 31, 2003, 2004, and 2005. Based on funding data obtained from the Department, STI's Upper Darby school received $9,830,436 in Pell, FSEOG, and Direct Loan funds during the ineligible years ($3,230,402, $3,540,502, and $3,059,532, during FYs 2004, 2005, and 2006, respectively). We determined that STI had included ineligible non-Title IV amounts in its FY 2003, 2004, and 2005 90 Percent Rule calculations and improperly excluded eligible Title IV amounts in its 90 Percent Rule calculations for FY 2004 and 2005.

Proprietary Schools Are Required to Generate at Least 10 Percent of Their Revenue from Non-Title IV Sources

Section 102(b)(1)(F) of the HEA specifies that a proprietary institution of higher education is "a school that ... has at least 10 percent of the school's revenues from sources that are not derived from funds provided under title IV, as determined in accordance with regulations prescribed by the Secretary." Conversely, no more than 90 percent of total revenue may be derived from the Title IV programs. This institutional eligibility requirement is codified at 34 C.F.R. § 600.5(a)(8). Pursuant to 34 C.F.R. § 600.5(d)(1) –

> An institution satisfies the requirement contained in paragraph (a)(8) of this section by examining its revenues under the following formula for its latest complete fiscal year:
>
> *Title IV, HEA program funds the institution used to satisfy its students' tuition, fees, and other institutional charges to students*
>
> ---
>
> *The sum of revenues including title IV, HEA program funds generated by the institution from tuition, fees, and other institutional charges for students enrolled in eligible programs as defined in 34 CFR 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.*

Pursuant to 34 C.F.R. § 600.5(d)(2) an institution must use the cash basis of accounting in reporting Title IV, HEA, program funds in the numerator and revenues generated in the denominator of the 90 Percent Rule calculation.

On July 15, 1999, the Department published proposed regulations to amend the regulations that govern institutional eligibility for and participation in the SFA programs authorized under Title IV of the HEA. In the preamble the Secretary stated that –

> Under the cash basis of accounting revenue is recognized by an entity when that entity receives cash, i.e., when there is an inflow of cash to the entity. . . . As a result, in order for an institution to recognize revenue under the cash basis of accounting, that revenue must represent cash received from a source outside the institution. [Federal Register, Volume 64, No. 135, page 38276]

Consequently, institutions may only include revenue from sources independent of the institution that is accounted for on the cash basis of accounting in the denominator of the calculation.

On October 29, 1999, the Department published the final regulations to amend the regulations that govern institutional eligibility for and participation in the SFA programs authorized under Title IV of the HEA. In the preamble, the Secretary discussed the sale of institutional loans for the purpose of the 90 Percent Rule calculation –

> Revenue generated from the sale of non-recourse institutional loans to unrelated parties would be counted as revenue in the denominator of the 90/10 calculation to the extent of actual proceeds. [Federal Register, Volume 64, Number 209, page 58610]

Accordingly, revenue from the sale of institutional loans is included in the 90 Percent Rule calculation only when it is received from an unrelated party.

The regulations at 34 C.F.R. § 600.31(b)(2) define "control" and "ownership" –

> Control. Control (including the terms controlling, controlled by and under common control with) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. . . . Person includes a legal person (corporation or partnership) or an individual.
>
> Ownership or ownership interest. (1) Ownership or ownership interest means a legal or beneficial interest in an institution or its corporate parent, or a right to share in the profits derived from the operation of an institution or its corporate parent.

STI Improperly Included Sales of Written-Off Student Accounts Sold to a Related Party as non-Title IV Revenue in its Upper Darby School's FY 2003 and 2004 90 Percent Rule Calculations

STI improperly included $202,925 and $105,447 of revenue in its Upper Darby school's 90 Percent Rule calculations for FY 2003 and 2004, respectively. These funds, which were from the sale of previously written-off student accounts receivable, were received from United Financial Group, Inc. (United), which was owned by a related party with a controlling and ownership interest in STI. The regulations provide that revenues included in the calculation are limited to revenues generated for the training of students and received from Title IV sources or from sources independent of the institution. By definition, funds received from a related party cannot on their face be considered independent of the institution.

Financial Accounting Standard 57, paragraph 3 provides –

> Transactions involving related parties cannot be presumed to be carried out on an arm's-length basis, as the requisite conditions of competitive, freemarket dealings may not exist. Representations about transactions with related parties, if made shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's length transactions unless such representations can be substantiated.[1]

Nerak owned and operated STI. The President of STI owned 100 percent of the voting stock in Nerak and 81.9 percent of its non-voting stock. The President of STI also owned 100 percent of United, a collection agency used by STI. The one and only United employee was paid from STI's payroll account.

The President of STI had direct control of and a majority ownership interest in both STI and United, resulting in STI and United being related parties. In December 2006, STI's independent public accountant issued revised FY 2003 and 2004 financial statements to disclose STI's sale of student accounts to United as a related party transaction.[2]

STI's President, Vice-President, and Chief Financial Officer (CFO) signed a statement confirming the following regarding the sales of STI's student accounts to United –

> In evaluating the Upper Darby school's 90-10 calculations for 2003 and 2004 STI's CFO determined that Upper Darby needed to generate cash receipts and that selling the school's accounts receivable to UFG [United] was a way to manage the 90-10 ratio.

[1] The Statement of Financial Accounting Standards No.57, Related Party Disclosures, was published in March 1982, by the Financial Accounting Standards Board (FASB). FASB standards are considered to be generally accepted accounting principles.

[2] As of June 2007, STI had not submitted the revised financial statements to the Department. On June 6, 2007 the OIG forwarded the revised statements to the Department's Office of Federal Student Aid.

In Fiscal Years 2003 and 2004 STI sold some of its Egg Harbor and Upper Darby schools' accounts receivable, at a discount rate to UFG [United] as follows:

School	Fiscal Year	Accounts Receivable Sold	Discount Fees Paid
Upper Darby	2003	$29,748	$7,101
Egg Harbor	2003	$173,177	$42,353
[Totals		$202,925	$49,454]
Upper Darby	2004	$45,178	$19,938
Egg Harbor	2004	$60,269	$22,821
[Totals		$105,447	$42,759]

STI's CFO determined the specific student accounts that were sold from Upper Darby and Egg Harbor to UFG [United]. In 2003 and 2004 the accounts sold included accounts for the same student debt that UFG [United] was already collecting on. UFG [United] wrote checks to STI for the full amount of the accounts receivable purchased. STI then wrote checks back to UFG [United] for the discount fees.

The total amount of accounts receivable sold from STI to UFG [United] is included as revenue (the total amount of accounts receivable sold is not netted against the discount fee paid) in Upper Darby's fiscal year 2003 and 2004 90-10 [Percent Rule] calculations.

All of the student accounts sold from STI's Upper Darby and Egg Harbor schools to United were for students that had dropped out or graduated from STI with a balance due on their accounts. STI had written-off the balances due on these student accounts as uncollectible prior to selling them to United. We found that in FY 2003, United purchased $126,984 of the $202,925 in student accounts from STI on December 10 – just three weeks prior to the end of the institution's fiscal year.

In FY 2003 and 2004 United purchased the student accounts for 76 percent ($202,925 – 49,454 / $202,925) and 60 percent ($105,447 – 42,759 / $105,447), respectively, of the student account balances that STI had written-off. This was in spite of the fact that according to United's Collection History Report, United had collected less than 1 percent on Upper Darby and Egg Harbor student accounts that had been written-off.

The common ownership of STI and United, STI officials' statement that the sale of student accounts was a way to manage the 90-10 ratio, United's purchase of the student accounts for amounts far exceeding its recovery history, and the date of the December 10, 2003 sale all support the conclusion that the $202,925 and $105,447 in sales of student accounts do not represent revenue to STI from a source that is outside the institution and were not arm's-length transactions. As a result, the sales should be excluded from STI's Upper Darby school's FY 2003 and 2004 90 Percent Rule calculations. We reduced the denominators of the FY 2003 and 2004 90 Percent Rule calculations by the amounts of the proceeds from the sales, as shown in Tables 1 and 2 on page 16.

STI's Comments:

STI did not concur that the sales of its Upper Darby and Egg Harbor schools' student accounts to United should be excluded from its Upper Darby school's FY 2003 and 2004 90 Percent Rule calculations. STI's response explained –

- Though STI Upper Darby and United are related through common ownership, the payments made by United were valid because United is a separate corporation, the purchases were made on a non-recourse basis, payment amounts were reasonable, and the proceeds were an in-flow of revenue. Had STI known that United's purchases were to be excluded from the calculation, it could have sold its receivables to other, unrelated companies. STI's independent audits did not note any problems with the purchases by United, and it is unfair to penalize STI many years after it "made a reasonable interpretation of an ambiguous 90-10 regulation and proceeded in good faith . . . ."

- The Draft Report misplaced significance on STI's practice of writing-off the student account balances for all of its out of school students. The fact that STI had written-off the student accounts that were sold to United did not mean that the proceeds of the sales of these student accounts could not be included in its 90 Percent Rule calculations.

- The 90-10 regulations did not declare that the sales of tuition receivables should be excluded from the 90 Percent Rule calculation, and there was no guidance from the Department as to the conditions and circumstances under which proceeds from the sales of student accounts could be included in the calculation. The Department did not reject or question STI's Upper Darby school's 90 Percent Rule calculations included in STI's FY 2003 and 2004 financial statements. The exclusion of United's payments from STI's Upper Darby school's FY 2003 and 2004 90 Percent Rule calculations at this late date would deprive STI's Upper Darby school of any compensation for educational services it provided years ago. The Statement of Financial Accounting Standards No.57 did not require or support the conclusion that United's student account payments must be excluded from STI's Upper Darby school's 90 Percent Rule calculations.

OIG's Response:

Our finding and the exception remains unchanged. Based on the Department's guidance cited in the report and the facts in this finding, STI has not shown that it complied with the regulations.

STI noted in its response that, "Star does not dispute that Star Upper Darby and United are related through common ownership . . . ." As noted in our finding, the preamble to the July 15, 1999, Notice of Proposed Rulemaking clarifies that, under the regulations, institutions may include only revenue from sources independent of the institution that is accounted for on the cash basis of accounting in the denominator of the 90 Percent Rule calculation. Pursuant to 34 C.F.R. § 600.5 (d)(2), institutions are required to use the cash basis of accounting when they perform the 90 Percent Rule calculation. The Department has the authority to interpret this provision, and it does that in the preamble.

In connection with the issue of institutional loans, scholarships and transactions in general, the Secretary has stated that transactions will be evaluated to determine whether they are valid and not part of a scheme to artificially inflate an institution's tuition and fee charges and whether the transactions are artificial in nature.

Since STI's Upper Darby school and United were related parties and the purchase by United was of accounts receivable that had been specifically determined to be of no value to STI, we stand by our conclusion that the sales of student accounts were not a valid in-flow of revenue and should be excluded from STI's Upper Darby school's FY 2003 and 2004 90 Percent Rule calculations.

Contrary to STI's assertion, the report did not state that the proceeds of the sales of student accounts could not be included in STI's Upper Darby school's 90 Percent Rule calculations because the accounts had been written-off prior to selling them to United. The significance of the fact that STI had written-off the student accounts that were sold to United is that the valuation of the student accounts by STI was inconsistent with the amounts paid by United for them, indicating that the sales were not arms-length transactions and did not represent revenue from a source that was independent of the institution. STI sold the student accounts receivable in FYs 2003 and 2004 for a net 76 percent and 60 percent of their face value, respectively. However, prior to selling the student accounts receivable, which STI previously had written-off, STI should have revaluated the accounts receivable. STI did not provide any information to show that it revaluated these accounts or to show the basis of its revaluation of these accounts to establish the equivalency of an arms-length transaction.

STI's actions further indicate that these transactions were part of an intentional effort to artificially inflate non-Title IV revenue. United wrote checks (United's sole employee was on the payroll of STI) to STI for the full amount of the written-off student accounts receivable. STI then included the full amount of the checks in the 90 Percent Rule calculation and wrote checks back to United for the discount fees, resulting in lower, net purchase price.

STI's statement that when STI Upper Darby's FY 2003 and 2004 audited financial statements were filed with the Department, it did not reject or question the 90 Percent Rule calculations in those audits is misleading. The FY 2003 and 2004 financial statements were submitted to the Department in February 2005 and June 2005, respectively, and did not include a disclosure regarding the sale of student accounts receivable. Therefore, the Department would not have had reason to question the 90 Percent Rule calculations. As noted in this audit report, in December 2006, STI's independent public accountant issued revised FY 2003 and 2004 financial statements to disclose STI's sale of student accounts to United as a related party transaction. Consequently, the Department was not aware of the related party transaction at the time the financial statements were submitted. In fact, STI did not submit the revised financial statements to the Department.

Statement of Financial Accounting Standards Number 57 supports our conclusion that the receipt of funds from STI's sales of student accounts to United cannot be considered funds received from a source independent of STI. The standard requires that "Representations about transactions with related parties, if made, shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's-length transactions unless such representations can be substantiated. As stated above, STI did not provide any evidence to

substantiate that the sales of previously written-off accounts were on terms equivalent to those between unrelated parties.

STI's Upper Darby School's FY 2005 90 Percent Rule Calculation Included as Student Payment Revenue Funds Received from the Shareholders of STI's Parent Corporation

In FY 2005, STI included $226,578 recorded as student payment revenue in its Upper Darby school's 90 Percent Rule calculation. Through interviews with STI students we determined that $31,448 of the student payment revenue was not paid to STI by the students. According to STI's records, the student payment revenue was derived from cash and check payments received from students for institutional charges, which STI would deposit into its bank accounts.

On a weekly basis, each of STI's schools completed a "Deposit Log", which identified that week's student payments deposited to an STI bank account. The "Deposit Logs" included the following information for each payment –

- the date of receipt,
- a receipt number,
- the student name and SSN,
- the amount of the receipt, and
- a transaction description.

We contacted students with payments over $500, listed in STI's FY 2005 Upper Darby and Egg Harbor schools' "Deposit Logs," to verify the accuracy of the student payment data.

STI's FY 2005 Upper Darby and Egg Harbor schools' "Deposit Log" records showed the following student payment information –

School	Number of Students With Payments Over $500	Number of Student Payments Over $500	Total Amount of Student Payments Over $500
Upper Darby	23	29	$61,358
Egg Harbor	36	54	$132,614
Totals	59	83	$193,972

We were able to contact 18 of the 59 students with payments of $500 or greater during FY 2005. We were told by 11 of the 18 students that they had not made the payments that were recorded in the "Deposit Log" and credited to their student account cards. Further, 4 of the 11 students verified in writing that they had not made the payments. For one student with two payments over $500, the student confirmed, in writing, making one payment, but not making the other. The following tables summarize the payment data for the students contacted.

School	Number of Students Contacted With Payments Over $500	Number of Student Payments Over $500	Total Amount of Student Payments Over $500
Upper Darby	14	17	$35,487
Egg Harbor	4	7	$14,442
Totals	18	24	$49,929

School	Number of Students Contacted That Denied Making Payments Over $500	Number of Payments Over $500 That Students Denied Making	Total Amount of Payments Over $500 That Students Denied Making
Upper Darby	8	9	$21,001
Egg Harbor	3	3	$10,447
Totals	11	12	$31,448

In addition, STI's records indicated that for four of the twelve payments three students claimed they had not made –

- one payment for $4,795 was made over five years after the student had dropped,
- two payments totaling $5,160 were made over six years after the student had dropped, and
- one payment for $4,002 was made over seven years after the student had dropped.

During our exit conference, on January 17, 2008, we explained to STI officials that we were unable to verify the accuracy of the $31,448 in student payments for 11 of the 18 students contacted. On February 1, 2008, STI's CFO provided our office with a written response to the issues discussed at the exit conference. Regarding the $31,448 in student payments the CFO explained –

> The reason that OIG was unable to obtain confirmation directly from students that they had made these payments is that the payments were made on their behalf to the institution by . . . the four shareholders of Nerak, Enterprises, Inc., the corporation which owns Star Upper Darby. Every month during fiscal 2005, these individuals withdrew cash from their personal savings and checking accounts and pooled their funds to make gifts on behalf of various former students of Star Upper Darby, who still had unpaid balances on their accounts with the institution.

On February 4, 2008, STI's CFO provided our office with a listing by student and amount of all the FY 2005 student payments made by the shareholders on behalf of former students. The listing included 30 payments totaling $70,925 made on behalf of 27 students. All 27 of the students' account balances had been written-off as uncollectible prior to being paid by the shareholders. The 12 payments, totaling $31,448, that former students had denied paying were included as part of STI's listing.

Institutions may include revenue only from sources independent of the institution that is accounted for on the cash basis of accounting in the denominator of the 90 Percent calculation. [Federal Register, Volume 64, No. 135, July 15, 1999, page 38276]

Also, in the preamble to the October 29, 1999 final regulations to amend the regulations that govern institutional eligibility for and participation in the SFA programs authorized under Title IV of the HEA the Secretary stated that, ". . . funds donated to the institution by related parties may not count for purposes of the 90/10 calculation." [Federal Register, Volume 64, Number 209, page 58610]

STI included the $70,925 as non-Title IV revenue in its Upper Darby school's FY 2005 90 Percent Rule calculation. Since the payments were made by the four shareholders of the corporation that owned STI, the payments did not represent revenue to STI from a source that was independent of the institution. Consequently, as shown in Table 3 on page 16, we reduced the denominator of the FY 2005 90 Percent Rule calculation by $70,925, the amount of the student payment revenue that was paid by the shareholders.

STI's Comments:

STI did not agree that the $70,925 in payments made by the shareholders on behalf of former students should be excluded from its Upper Darby school's FY 2005 90 Percent Rule calculation. STI's response explained –

- The gifted funds qualify for inclusion, since the payments represent funds from sources outside the institution that were paid to cover tuition charges for students, similar to a gift from a family member or a stipend or grant from a state agency or external scholarship fund. Although the payments came from the after-tax resources of the four Nerak shareholders, who are admittedly related to the institution through their share of ownership and the 1999 preamble declares that gifts made by related parties must be excluded, there is no such prohibition in the statute or regulation. The language of the statute and regulation control here and tuition payments by an institution's shareholders from their personal resources represent an inflow of revenues from outside of the institution and funds from a source other than the Title IV programs.

OIG's Response:

Our finding and the exception remains unchanged. Based on the Department's guidance cited in the report and the facts in this finding, STI has not shown that it complied with the regulations.

STI noted in its response that the payments came from the after-tax resources of the four Nerak shareholders, who are admittedly related to STI's Upper Darby school through their share of ownership. As noted in our finding, the preamble to the July 15, 1999, Notice of Proposed Rulemaking clarifies that, under the regulations, institutions may include only revenue from sources independent of the institution that is accounted for on the cash basis of accounting in the denominator of the 90 Percent Rule calculation. Pursuant to 34 C.F.R. § 600.5(d)(2), institutions are required to use the cash basis of accounting when they perform the 90 Percent Rule calculation. The Department has the authority to interpret this provision, and it does that in the preamble.

Since the four Nerak shareholders and STI's Upper Darby school were related parties we stand by our conclusion that the payments did not represent revenue to STI from a source that was independent of the institution and should be excluded from STI's Upper Darby school's FY 2005 90 Percent Rule calculation.

In connection with the issue of institutional loans, scholarships and transactions in general, the Secretary has stated that transactions will be evaluated to determine whether they are valid and not part of a scheme to artificially inflate an institution's tuition and fee charges and whether the

transactions are artificial in nature. STI's other arguments are not pertinent to a determination of whether it has complied with the criteria.

STI Improperly Excluded Institutional Fees from the Numerator of its Upper Darby School's FY 2004 and 2005 90 Percent Rule Calculations

STI improperly excluded $48,900 and $54,200 in fee revenue from the numerator of its Upper Darby school's FY 2004 and 2005 90 Percent Rule calculations, respectively. STI did properly include the fee revenue in the denominator. The regulations at 34 CFR § 600.5(d)(1) require that Title IV, HEA program funds the institution used to satisfy its students' tuition, fees, and other institutional charges to students are included in the numerator and denominator of the 90 Percent Rule calculation.

STI charged all of its students $100 for institutional fees. The fees were included on STI's enrollment agreements, as part of the cost of tuition. STI's CFO explained that its independent public accountant had informed STI that the fees should be excluded from the 90 Percent Rule calculation. The CFO stated that the fee revenue was calculated by multiplying the number of new enrollments at its Upper Darby and Egg Harbor schools during each FY by $100. STI did not maintain a general account that identified the fee revenue.

The regulations at 34 C.F.R. § 600.5(e)(2) state –

> With regard to the [90 Percent] formula contained in paragraph (d)(1) of this section -
>
> In determining the amount of title IV, HEA program funds received by the institution under the cash basis of accounting ... the institution must presume that any title IV, HEA program funds disbursed or delivered to or on behalf of a student will be used to pay the student's tuition, fees, or other institutional charges ... and therefore must include those funds in the numerator and denominator.

Therefore, as shown in Tables 2 and 3 on page 16 we have added the fee revenue of $48,900 and $54,200 to the numerators of the FY 2004 and 2005 90 Percent Rule calculations, respectively.

STI's Comments:

STI explained that its initial approach with the institutional fees was not to include them in either the numerator or the denominator of the 90 Percent Rule calculation. However, as a result of a mathematical process error the fees were left in the denominator but removed from the numerator. STI stated that it now recognized and agreed that the institutional fees paid in FYs 2004 and 2005 should be included in both the numerator and denominator of its Upper Darby school's 90 Percent Rule calculations. However, STI stated that some students paid the institutional fees prior to any Title IV disbursement with cash payments made from their resources or those of their families. STI explained that the amount of fees paid directly by students from resources other than Title IV was $3,390 in FY 2004 and $1,803 in FY 2005. STI claimed that the $3,390 of fee income for FY 2004 and $1,803 of fee income for FY 2005, while properly included in the denominators of its Upper Darby school's 90 Percent Rule calculations

should not be included in the numerators of the calculations since these amounts came from student resources.

STI also asserted that the "presumption provision" under 34 C.F.R. § 600.5(e)(2) is inconsistent with the stated premise of the 90-10 statute and should not be applied to STI's Upper Darby school's FY 2004 and 2005 90 Percent Rule calculations.

OIG's Response:

Our finding and the exception remains unchanged. The regulations at 34 C.F.R. § 600.5(e)(2) require that the institution must presume that Title IV funds are used to pay the students tuition, fees, or other institutional charges with no provision for the timing of a student's payments. STI's comments do not provide a basis for considering the fees to have been paid with anything other than Title IV funds.

STI's argument that the "presumption provision" under 34 C.F.R. § 600.5(e)(2) is inconsistent with the stated premise of the 90-10 statute provides no basis to exclude STI from the requirements of the regulation.

STI Improperly Included Tuition Receipts for a Student that Attended its Roosevelt, PA School as Non-Title IV Revenue in its Upper Darby School's FY 2004 90 Percent Rule Calculation

We noted that a $1,613 tuition payment, made in December 2004, by a student that attended STI's Roosevelt, PA, school was erroneously included as tuition revenue in its Upper Darby school's FY 2004 general ledger tuition account. As a result, the $1,613 was improperly included as non-Title IV revenue in STI's Upper Darby school's FY 2004 90 Percent Rule calculation.

The student's account card and diploma indicated that she had attended STI's Roosevelt, PA, school. In addition, we were told by the student that she had enrolled, attended and graduated from the Roosevelt, PA school. STI's Roosevelt, PA, school is a main campus with an additional location in Newark, NJ; it is not a part of STI's Upper Darby school.

The regulations at 34 C.F.R. § 600.5(e)(4) state –

> With regard to the [90 Percent] formula ...[w]ith regard to the denominator, revenue generated by the institution from activities it conducts, that are necessary for its students' education or training, includes only revenue from those activities that –
>
> (i) Are conducted on campus or at a facility under the control of the institution . . .

Since the tuition payment was for another school, we reduced the denominator of the FY 2004 90 Percent Rule calculation by the $1,613 Roosevelt tuition payment, as shown in Table 2 on page 16.

STI's Comments:

STI concurred with the exception and agreed that the $1,613 Roosevelt tuition payment should be excluded from the denominator of STI's Upper Darby school's FY 2004 90 Percent Rule calculation.

STI Included a Disbursement that Was Never Received as Non-Title IV Revenue in its Upper Darby School's FY 2005 90 Percent Rule Calculation

STI erroneously included $1,839 for a student's scheduled Sallie Mae disbursement as non-Title IV tuition revenue in its FY 2005 Upper Darby school's 90 Percent Rule calculation. The $1,839 Sallie Mae disbursement was not received by the school.

STI's CFO agreed that the scheduled Sallie Mae disbursement had not been received by the school. STI made an adjusting entry in January 2006 to the Upper Darby school's general ledger tuition account to reduce tuition receipts by $1,839; however, it did not revise its 90 Percent Rule calculation.

An institution must use the cash basis of accounting in determining whether it satisfies the 90 Percent Rule. Under the cash basis of accounting an institution may recognize revenue only when it receives cash. [34 C.F.R. § 600.5(d)(2) and the Preamble from the July 1999 Notice of Proposed Rulemaking as cited at pages 4 and 5]

Consequently, we reduced the denominator of the FY 2005 90 Percent Rule calculation by $1,839, as shown in Table 3 on page 16.

STI's Comments:

STI concurred with the exception and agreed that $1,839 should be excluded from the denominator of STI's Upper Darby school's FY 2005 90 Percent Rule calculation.

STI's 90 Percent Rule Calculations

STI reported in the notes to its FY 2003, 2004, and 2005 audited financial statements that its Upper Darby school met the 90 Percent Rule with 89.35 percent, 89.48 percent, and 89.29 percent of its revenue from Title IV sources, respectively.[3] Based on our analysis, STI received 96.16 percent, 94.67 percent, and 92.67 percent of its cash revenue from Title IV sources during the FYs 2003, 2004, and 2005, respectively, and therefore, did not comply with the 90 Percent Rule.

[3] STI's CFO provided us with the amounts it used in its 90 Percent Rule calculations. The FY2005 90 Percent calculation was 89.26 percent; however, 89.29 percent was reported in its FY 2005 financial statements.

TABLE 1
STI and OIG Calculated Percentages of Title IV Revenue
January 1, 2003 to December 31, 2003

Funding Source	STI Calculation	Funds from Related Party	OIG Calculation
Title IV Receipts	$2,564,623		$2,564,623
Non-Title IV Receipts	$305,360	($202,925)	$102,435
Total Revenue[4]	$2,870,183		$2,667,058
Title IV Revenue as a Percent of Total Revenue	**89.35%**		**96.16%**

TABLE 2
STI and OIG Calculated Percentages of Title IV Revenue
January 1, 2004 to December 31, 2004

Funding Source	STI Calculation	Funds from Related Party	Institutional Fees	Roosevelt Tuition Payment	OIG Calculation
Title IV Receipts	$2,590,165		$48,900		$2,639,065
Non-Title IV Receipts	$255,627	($105,447)		($1,613)	$148,567
Total Revenue[4]	$2,894,692				$2,787,632
Title IV Revenue as a Percent of Total Revenue	**89.48%**				**94.67%**

TABLE 3
STI and OIG Calculated Percentages of Title IV Revenue
January 1, 2005 to December 31, 2005

Funding Source	STI Calculation	Payments Denied By Students	Institutional Fees	Disbursement Not Received	OIG Calculation
Title IV Receipts	$3,185,809		$54,200		$3,240,009
Non-Title IV Receipts	$329,137	($70,925)		($1,839)	$256,373
Total Revenue[4]	$3,569,146				$3,496,382
Title IV Revenue as a Percent of Total Revenue	**89.26%**				**92.67%**

[4] The STI calculated Total Revenue amount does not equal the sum of the Title IV Receipts and Non-Title IV receipts because the Title IV institutional fee revenue was included in the denominator, but was improperly excluded from the numerator of the 90 Percent Rule calculation.

Institutions that fail to satisfy the 90 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. [34 C.F.R. § 600.40(a)(2)] To regain its eligibility an institution must demonstrate compliance with all eligibility requirements for at least the fiscal year following the fiscal year that it failed to comply with the 90 Percent Rule. [34 C.F.R. § 600.5(g)]

STI also violated the rules of Title IV program eligibility by not complying with its program participation agreement.

The regulations at 34 C.F.R. § 668.14(b)(1) state –

> By entering into a program participation agreement, an institution agrees that –
>
> It will comply with all statutory provisions of or applicable to Title IV of the HEA, [and] all applicable regulatory provisions prescribed under that statutory authority . . .

Pursuant to 34 C.F.R. § 668.86(a)(1) –

> The Secretary may limit or terminate an institution's participation in a Title IV, HEA program . . . if the institution . . .
>
> (i) Violates any statutory provision of or applicable to Title IV of the HEA, any regulatory provision prescribed under that statutory authority . . .

Recommendations

We recommend that the Acting Chief Operating Officer for FSA:

1.1 Initiate action under 34 C.F.R. § 668.86(a)(1) to terminate STI's Upper Darby school from participation in the Title IV programs.

1.2 Require STI to return $9,830,436 in Pell, FSEOG, and Direct Loan funds to the Department that its Upper Darby school received from January 1, 2004, through December 31, 2006.

1.3 Require STI's Upper Darby school to return all Title IV monies received after December 31, 2006, if the Secretary has not made a determination under 34 C.F.R. § 600.5(g) that the school demonstrated compliance with all eligibility requirements for at least the fiscal year ended December 31, 2006.

STI's Comments:

STI did not concur with the Draft Report recommendations. Regarding Draft Report Recommendation 1.1 STI's response stated –

- The Recommendation asks the Department to terminate STI's Upper Darby school from participation in the Title IV programs because it failed the 90-10 Rule in FYs 2003, 2004, and 2005. However, the 90-10 regulation 34 C.F.R. § 600.5(g), only requires an institution failing the 90-10 Rule in any given year, to be excluded for one subsequent year (the "Exclusion Year"), after which the institution may apply to be readmitted to the

Title IV programs if it meets the 90-10 Rule during the Exclusion Year and satisfies institutional eligibility requirements. This is the approach the Department has followed with institutions that have lost Title IV eligibility due to failing the 90-10 Rule.

STI stated that the Draft Report Recommendations 1.2 and 1.3 are not consistent with Department regulations and practice. STI's response explained –

- Regarding Recommendations 1.2 and 1.3 the liability for Title IV aid disbursed is in error and must be revised to be consistent with the Department's practice of only requiring payment on the "loss" portion of loan funds. In addition, any liability for Title IV funds would also have to be reduced by the amount of the "teachout credit" to which STI's Upper Darby school would be entitled under 34 C.F.R. § 668.26.

In addition, STI commented that, "OIG did not audit or otherwise review Star Upper Darby's Title IV funds percentage for fiscal years 2006 and 2007, even though Star invited the OIG to do so and Star also submitted a revenue breakdown to the OIG for each of those years."

STI also stated that, "The 90-10 statute, 20 U.S.C. § 1002 (b)(1)(F), both on its face and as interpreted and applied in the Draft Report, violates the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution."

OIG's Reply:

Contrary to STI's assertions, our recommendations are consistent with the applicable laws and regulations cited. Regarding STI's comments on Draft Report Recommendation 1.1, our recommendation to initiate action to terminate STI's Upper Darby school is not pursuant to 34 C.F.R. § 600.5(g), but is based on STI's violation of the terms of its participation agreement pursuant to the requirement under 34 C.F.R. § 668.86(a)(1) which provides for the Secretary to terminate an institution for any violation of the HEA or regulations. STI improperly calculated and reported compliance with the 90 Percent Rule for three years and received Title IV funds for years in which it was in fact ineligible. The remedy of sitting out a year under 34 C.F.R. § 600.5(g) applies only to schools that accurately and timely report non-compliance with the 90 Percent Rule. In this case, STI's actions indicated that it engaged in intentional conduct that artificially inflated non-Title IV revenue.

Concerning STI's comments on Draft Report Recommendations 1.2 and 1.3, during the audit resolution process, the Chief Operating Officer for FSA will determine whether or not to use the Department's loan loss formula or "teachout credit" to determine the amount of the liability.

Regarding STI's comment that the OIG did not review its Upper Darby school's FYs 2006 and 2007 90 Percent Rule calculations, those FYs were not within the scope of our audit and therefore not reviewed. The audit report recommendations are based on our review of STI's Upper Darby school's 90 Percent Rule calculations for FYs 2003, 2004 and 2005. We saw no need to expand our audit period to include later years.

Concerning STI's comment that the 90 Percent Rule provision in the HEA is unconstitutional, a similar claim was rejected by the court in Ponce Paramedical College, Inc., v. United States

Department of Education, 858 F. Supp. 303, 314-5 (D.P.R. 1994) (predecessor 85-15 Rule "does not offend the Constitution").

OBJECTIVE, SCOPE, AND METHODOLOGY

The purpose of our audit was to determine whether STI's Upper Darby school complied with the 90 Percent Rule, Section 102(b)(1)(F) of the HEA, and had sufficient, reliable accounting records to support its 90 Percent Rule calculations for the FYs ended December 31, 2003, 2004, and 2005.

To accomplish our audit objective, we performed the following procedures –

- Reviewed selected provisions of the HEA, regulations, and FSA guidance applicable to the audit objective.
- Reviewed STI's website and school catalog to gain an understanding of its history and organization.
- Reviewed STI's Upper Darby school's Eligibility and Certification Approval Report and its Program Participation Agreement.
- Reviewed STI's Financial Statements and STI's Upper Darby school's Compliance Audit Reports for the FYs ended 2003, 2004, and 2005.
- Interviewed STI's CFO to gain an understanding of STI's policies and procedures for preparing its 90 Percent Rule calculations.
- Interviewed United's Administrator to gain an understanding of United's debt collection procedures.
- Obtained STI's Upper Darby school's FY 2003, 2004, and 2005 90 Percent Rule calculations and supporting detail, including its accounting records.
- Analyzed the composition of the numerators and denominators for STI's Upper Darby school's 90 Percent Rule calculations.
- Recalculated the 90 Percent Rule calculations for STI's Upper Darby school.

To achieve our audit objective, we relied, in part, on the computer-processed data in STI's Excel spreadsheet calculations for its Upper Darby school's FY 2003, 2004 and 2005 90 Percent Rule percentages. The Excel spreadsheets listed STI's year-to-date receipts, refunds, and net receipts by funding category and showed the 90 Percent rule percentage. The funding categories are as follows –

- Title IV (Pell, FSEOG and Direct Loan)
- Non-Title IV (Private Payments, Job Training Partnership Act (JTPA), United Collections, and Fees)
- Title IV and Non-Title IV (Stipends)

We verified the completeness of the data by comparing the totals for all of the funding categories for the 90 Percent Rule calculations to the totals per STI's Upper Darby and Egg Harbor schools' corresponding general ledger accounts. We also compared the Title IV categories to the Title IV

data in the Department's Grants Administration and Payments System.[5] We verified the authenticity of the data by comparing the supporting detail for the Excel spreadsheet 90 Percent Rule calculations to the accounting records and other supporting documentation. Specifically, we used the data contained in STI's Upper Darby and Egg Harbor schools' general ledger accounts as our sampling universe for testing its compliance with the 90 Percent Rule.[6] We randomly selected sample transactions for review as follows –

- Reviewed 2 FY 2004 JTPA credit record transactions totaling $14,744 that represented costs for 3 JTPA recipients from the universe of 18 credit records, totaling $77,565, recorded in STI's Upper Darby and Egg Harbor schools' FY 2004 General Ledger Tuition Accounts.[7]

- Reviewed 2 FY 2005 JTPA credit record transactions totaling $13,561 that represented costs for 10 JTPA recipients from the universe of 25 credit records, totaling $115,595, recorded in STI's Upper Darby and Egg Harbor schools' FY 2005 General Ledger Tuition Accounts.[7]

- Reviewed 20 FY 2004 Stipend debit record transactions totaling $4,545 that represented costs for 19 Stipend recipients from the universe of 2,856 debit records, totaling $449,618, recorded in STI's Upper Darby and Egg Harbor schools' FY 2004 General Ledger Account, Stipends.[8]

- Reviewed 20 FY 2005 Stipend debit record transactions totaling $5,041 that represented costs for 18 Stipend recipients from the universe of 2,031debit records, totaling $331,229, recorded in STI's Upper Darby and Egg Harbor schools' FY 2005 General Ledger Accounts, Stipends and L&T.[8]

- Reviewed the records for 20 FY 2004 refunds, totaling $44,665, from the universe of 153 refunds, totaling $289,870, recorded in STI's Upper Darby and Egg Harbor schools' FY2004 Subsidiary Trial Balance Refund Reports.[9]

- Reviewed the records for 20 FY 2005 refunds, totaling $34,204, from the universe of 209 refunds, totaling $389,967, recorded in STI's Upper Darby and Egg Harbor schools' FY2005 Subsidiary Trial Balance Refund Reports.[9]

[5] Due to time constraints, we did not compare the FY 2003 funding category totals to the corresponding general ledger accounts.
[6] Due to time constraints, FY 2003 testing was only performed on the private payment funding category. For FYs 2004 and 2005 we did not perform tests of the United collections funding category due to the small dollar amount. Also, we could not perform tests of the Fees funding category as the amounts were not supported by the general ledger.
[7] Records reviewed included JTPA agreements, copies of the JTPA checks, and student account cards.
[8] Records reviewed included copies of the stipend checks and student account cards. In FY 2005 STI began paying one time lump sum stipend payments from its general ledger account L&T and paying weekly stipend payments from its general ledger account Stipends.
[9] Records reviewed included Return to Title IV calculations, state refund calculations, copies of the refund checks, STI's Federal Pell and Direct Loan bank accounts, data in the Department's Common Origination and Disbursement computer system, and student account cards.

We reviewed the records for the entire universe of FY 2003, 2004, and 2005 private payments. The universes are as follows[10] –

FY 2003

School	Number of Payments	Amount
Upper Darby	57	$50,556
Egg Harbor	117	$197,992
Totals	174	$248,548

FY 2004

School	Number of Payments	Amount
Upper Darby	106	$70,942
Egg Harbor	150	$117,917
Totals	256	$188,859

FY 2005

School	Number of Payments	Amount
Upper Darby	134	$82,747
Egg Harbor	155	$152,736
Totals	289	$235,483

We also judgmentally selected and contacted students with payments equal to or greater than $500 to corroborate the accuracy and validity of the payments as follows –

- For FY 2004 we contacted 5 students, whose STI records showed had made 10 payments, totaling $20,535, from the universe of 21 students with 30 payments totaling $51,515; and
- For FY 2005 we contacted 18 students, whose STI records showed had made 24 payments, totaling $49,929, from the universe of 59 students with 83 payments totaling $193,972.

Based on our preliminary assessment, we concluded that the computer-processed data included in STI's Excel spreadsheet calculations for its Upper Darby school's FY 2003, 2004 and 2005 90 Percent Rule percentages were sufficiently reliable for the purpose of our audit.

We did not perform a review of internal controls or rely on internal controls to accomplish our audit objective.

We performed our audit work at STI's corporate office in Berlin, NJ from June 18, 2007 through June 22, 2007, and from October 17, 2007 through October 18, 2007. We discussed the results of our audit with STI officials on January 17, 2008. Our audit was performed in accordance with

[10] Records reviewed included STI Deposit Logs and bank account statements.

generally accepted government auditing standards appropriate to the scope of the review described above.

ENCLOSURE: Star Technical Institute's Comments on the Draft Audit Report

TECHNICAL INSTITUTE

May 15, 2008

Via Email
Bernard.tadley@ed.gov
Mr. Bernard Tadley
Regional Inspector General for Audit
Office of the Inspector General
U.S. Department of Education
The Wanamaker Building
100 Penn Square East, room 502
Philadelphia, PA 19107

Re: Star Technical Institute - Upper Darby, OPE ID No. 02539900:
Draft OIG Audit Report, Control Number Ed-OIG/A03H0009

Dear Mr. Tadley:

Star Technical Institute - Upper Darby ("Star" or "Star Upper Darby") has reviewed the Draft Audit Report issued on April 15, 2008 by the Office of Inspector General, Control Number ED-OIG/A03H0009, entitled "Star Technical Institute's Upper Darby School's Compliance with the 90 Percent Rule" (the "Draft Report" or "DR"). Based on determinations about certain revenue components, the Draft Report concludes that Star Upper Darby failed to comply with the 90 Percent Rule in fiscal years 2003, 2004 and 2005. For the reasons stated in this response, we disagree with this overall conclusion and we ask that your office reconsider and revise the underlying determinations and recommendations which are discussed below in this response.

I. Introduction

Star does not object to two of the Draft Report's proposed conclusions:

(i) Cash paid by a student at the Star Technical Institute - Roosevelt campus should be excluded from the 90-10 calculation for Star - Upper Darby; and

(ii) A Sallie Mae private loan acknowledgement report disbursement was received by the institution but an actual disbursement was not received due to an error made by the lender, and thus this disbursement should also be excluded from the 90-10 calculation.

Star, however, strongly disagrees with three other conclusions in the Draft Report:

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(i) Proceeds from the sale of tuition receivables to United Financial Group, Inc. ("United") should be excluded from the Star Upper Darby's 90-10 calculations for fiscal years 2003 and 2004 (the "Sales Finding");

(ii) Cash gifts made on behalf of former students by shareholders of Star's owner, Nerak Enterprises, Inc. ("Nerak"), should be excluded from Star - Upper Darby's 90-10 calculation for fiscal 2005 (the "Gifts Finding"); and

(iii) Book and supply charges paid with Title IV funds should be included in the 90-10 calculation (the "Fees Finding").

Star also disagrees with the Draft Report's recommendations that: (a) the Federal Student Aid Office (FSA) should terminate the Title IV eligibility of Star Upper Darby's fiscal year 2005; and (b) Star should be required to pay $9,830,436 for Title IV funds received by Star Upper Darby students during fiscal years 2004, 2005 and 2006.

In addition to the specific conclusions and recommendations referenced above, Star objects to the Draft Report's general observations that an institution cannot count non-Title IV cash receipts in the 90 Percent or 90/10 Rule calculation unless those receipts are from "sources independent of the institution" (DR at 5) and that an institution cannot count the proceeds from the sale of institutional loans in the 90 Percent calculation unless that sale was made to "an unrelated party." *Id.* Neither the language nor the purpose of the 90/10 statute supports such limitations upon non-Title IV revenue includible in the in the 90/10 calculation. The stated congressional premise for the 90% limitation – originally an 85% limitation – was that institutions offering a quality education should be able to attract some minimal level of tuition revenues from sources other than the Title IV programs. *See Career College Ass'n v. Riley*, 70 F.3d 637, 1995 WL 650151, at *2 (D.C. Cir. 1995).

Even if the premise of the 90/10 Rule is sound (see discussion below in Section VII questioning the validity of the premise), cash revenue from a related party – such as a company affiliated with an institution or shareholders of the company owning the institution – is revenue from a source other than the Title IV programs and is revenue contributed because the related person or entity regarded the institution's educational programs as being worthy of funds contributed either to pay tuition or to purchase tuition receivables. While, as noted by the Draft Report, the 1999 preamble to the 90/10 regulation does observe that sales of tuition loans or receivables must be to "an unrelated party" in order to be counted in the 90-10 calculation, the 90-10 regulation does not contain any such limitation. *See* 34 C.F.R. § 600.5 (d) – (e). Indeed, to the contrary, the regulation suggests that proceeds from any sale of loans can be included in the 90/10 calculation, since it states broadly that institutions may include "the amount of loan repayments received by the institution during the fiscal year," 34 C.F.R. § 600.5 (d)(3)(i), and proceeds from the sale of loans are essentially "repayments" of loans.

Before addressing the reasons why Star disagrees with the Sales Finding, the Gifts Finding, the Fees Finding and the recommendations, Star believes that a brief review of Star Upper Darby's programs, students, regulatory metrics and student outcomes will contribute to a more complete and correct understanding of Star Upper Darby's compliance with what the Draft Report terms the "90 Percent Rule," i.e., the requirement, under 20 U.S.C. § 1001 (b)(1)(F) and

34 C.F.R. § 600.5 (a)(8) & (d)(1), that a for-profit institution receive no more than 90.0% of its revenues for tuition and related charges from the Title IV federal financial assistance programs.

II. Star Upper Darby – Profile

Star was founded in 1984 and over the years it has been owned and operated as a family business. Star acquired the Star Upper Darby institution approximately 15 years ago, and, throughout the period of its ownership by Star, the institution has participated in the Title IV financial aid programs. Star Upper Darby, during all time periods relevant to the Draft Report, has consisted of an Upper Darby, Pennsylvania main campus and an Egg Harbor, New Jersey branch campus. In addition to the Star - Upper Darby institution, Star owns two other freestanding institutions: (1) Star Roosevelt (OPE ID No. 02615400) with a main campus in Philadelphia (at 9121 Roosevelt Boulevard) and a branch campus in Newark, New Jersey and (2) Star Stratford (OPE ID No. 02586900) with a main campus in Stratford, New Jersey and branch campuses in Lakewood, New Jersey and Dover, Delaware. Altogether there are three Star institutions, all owned by Nerak, with seven campuses.

Star Upper Darby's main campus is located in an urban area that is populated primarily by low income families and, as a consequence, well over 90% of the institution's students qualify for some level of Pell Grant assistance and more than 80% of its students have what is known as a Pell zero EFC index that qualifies them for the maximum Pell Grant available relative to their costs of attendance. Star – Upper Darby offers these low income students the opportunity to gain new careers with increased wages by acquiring vocational skills through short-term allied health and technology programs averaging around 10 months in length. These programs are competitively priced, such that students qualifying for maximum Title IV grant and loan aid – which is well over 80% of the student body – can pay 100% of the institution's charges with Title IV funds. These same students, at the Upper Darby campus, also receive a small state grant and institutional loans. Because Star Upper Darby serves so many low income students receiving maximum Title IV funds that equal 100% of the institution's charges, Star Upper Darby's Title IV funds percentages have always been in the upper 80s.

What is most important about Star Upper Darby's service to low income students is that the institution has achieved remarkable results despite the significant challenges faced by these students, with graduation rates averaging over 60% and placement rates averaging over 75%. If Star Upper Darby was not serving these students, many of them likely would be stuck in low income entry level unskilled jobs and on government welfare rolls. Star's commitment to its students is also evidenced in its reinvestment of substantial amounts of revenue to improve physical plant and educational programs. In 2003, Star reinvested $336,212 out of net income of $700,805 in new capital equipment and also paid $1,320,065 in Title IV credit balances to students for their use in meeting personal expenses. In 2004, reinvested $406,911 in capital equipment on net income of only $366,983 and paid $1,317,514 in Title IV credit balances to students. And in 2005, Star reinvested $532,732 in new equipment on net income of only $330,381 and paid $895,509 in Title IV credit balances to students. Clearly, Star has made service to its students its foremost priority.

Other than the Draft Report's conclusion that Star Upper Darby failed to comply with the 90 Percent Rule for fiscal years 2003 to 2005, Star Upper Darby has earned good marks from all of its regulators. In 1995, for example, the institution's accrediting body, the Accrediting

Commission for Career Schools & Colleges of Technology (ACCSCT), recognized the institution as a "School of Distinction," and, in the fall of 2007, the FSA Region III case team completed a program review of the institution (begun in July 2006) with no monetary liabilities and no unresolved findings. Star Upper Darby would not be facing the disputed 90-10 findings in the Draft Report if FSA regulations had stated that receivable sales to related collection agencies will always be disallowed no matter what the terms of the transactions and that tuition cash gifts by shareholders of an institution will always be disallowed. Had Star been aware that OIG held the view that non-Title IV revenue of this nature never can be included in the 90-10 rule, there were several alternative actions Star could have taken to keep its Title IV percentage below 90.1%, including raising tuition, selling receivables to completely unrelated parties, soliciting scholarship funds from unrelated parties such as foundations, and merging all seven Star campuses into a single OPE ID number which would have yielded a single 90-10 score below 90.1% for all of the fiscal years at issue here (because several of the other Star campuses have a more economically diverse student body including students who do not qualify for maximum Title IV aid and also students who also have access to higher state aid in New Jersey).

III. The Sales Finding

The Draft Report states that payments made to Star Upper Darby during fiscal years 2003 and 2004 by United, for the purchase of institutional loans (or tuition receivables) should be excluded from Star Upper Darby's 90-10 calculations for those years, because United is related by ownership to Star, inasmuch as Star's president and principal shareholder also possessed the majority ownership of United (DR at 6). Star does not dispute that Star Upper Darby and United are related through common ownership, but Star does dispute the conclusion that the Draft Report reaches based on this common ownership. Specifically, Star disagrees with the Draft Report's assertion that Financial Accounting Board Standard 57 requires the exclusion of the payments made by United to Star Upper Darby.

Significantly, the Draft Report does not dispute that United made payments to Star Upper Darby for actual purchases of receivables. During an exit interview, the OIG representatives acknowledged that, if United were not related to Star Upper Darby, OIG would not contest the inclusion of the payments in the 90-10 calculation. These payments by United totaled $202,925 in fiscal 2003 and $105,447 in fiscal 2004. There is no dispute that, if these payments are kept in the 90-10 calculations of Star Upper Darby, as the institution's CPA has determined they should be, then Star Upper Darby's 90-10 ratio for fiscal 2003 and fiscal 2004 does not exceed 90.0%. For the reasons outlined below, Star requests the OIG to reconsider the Sales Finding to provide that the proceeds of receivables sales to United can be included in the 90-10 calculation.

First, there are significant facts demonstrating that the payments made to Star Upper Darby by United for non-recourse purchases of receivables were valid payments that should be included in the 90-10 calculations for Star Upper Darby:

(1) United was and is a legitimate and separate New Jersey corporation engaged in the student loan collection business.

(a) United was formed and incorporated on January 7, 2000. Star has previously submitted to OIG copies of United's federal and New Jersey

corporate tax returns for the years 2003 and 2004, attesting to the fact that United is a legitimate separate business entity.

(b) United is not a postsecondary institution and did not provide any services to, or have any involvement with, Star Upper Darby other than collection of institutional loans and purchase of institutional loans.

(c)United has an employee that performs collection functions, including sending correspondence and making phone calls to student account debtors.

(2) United's loan purchases were made on a non-recourse basis and the prices which United paid to Star Upper Darby, after deduction of substantial discount fees paid by Star Upper Darby (ranging from around 24% to 40%), were manifestly reasonable and market value, in light of the fact the loans which United purchased were loans on which students had been making payments and continued to make payments, as reflected in a United loan collection status report previously provided to OIG.

(3) The non-recourse sale proceeds were an in-flow of revenue to the institution, which enhanced the institution's assets.

(4) There were other companies, unrelated to Star Upper Darby, to which it could have sold its student tuition receivables, including EFS, TFC, RRI, Transworld and Capital Collections.

(5) Star Upper Darby's independent auditors, who have experience with institutions of higher education and the Title IV programs, did not note any problems with these sales during their audits of the 2003 and 2004 fiscal years.

If OIG now ignores the foregoing facts or interprets them as insufficient to qualify the United loan purchase payments for inclusion in the 90-10 calculations for Star Upper Darby's fiscal years 2003 and 2004, then Star will be severely and unfairly penalized by a demand for repayment of millions of dollars of Title IV funds many years after Star made a reasonable interpretation of an ambiguous 90-10 regulation and proceeded in good faith to teach hundreds of students largely dependent on federal financial aid. During fiscal 2003 to 2005, Star Upper Darby paid substantial operating costs in order to provide educational training to over 1488 students, of which over 60% graduated. If these Title IV funds have to be repaid now, Star will not be able to obtain payments from these students served so many years ago, which means Star will suffer an enormous financial loss.

Second, the Draft Report misplaces significance on Star's write off practice and the overall performance of all Star institutional loans – factors that do not control whether proceeds actually received for the specific loans that were sold are includible in the 90-10 calculation. The fact that Star Upper Darby had a practice of writing off on its books receivables for students following their withdrawal from school does not mean that these loans had no value or that the proceeds of the sale of the loans to United cannot be included in the 90-10 calculation.

Regardless of the low overall collection rate on all Star out of school loans, the loans which Star sold to United were former loans that had recent performance history. And Star's practice of writing off all out of school student loans was simply a very conservative practice which it voluntarily adopted, but that voluntary practice did not deprive Star Upper Darby of the right to recognize proceeds actually paid for the performing loans which it sold to United.

Third, in addition to the foregoing significant facts, the following legal factors also warrant inclusion of the United payments in the 90-10 calculations of Star Upper Darby:

1. The 90-10 regulations do not declare that sales of tuition receivables to a company related to the seller institution should be excluded from the 90-10 calculation, and instead, as noted above, the regulations broadly state that any loan repayments received during the fiscal year – which includes proceeds of sales of loans – can be included in the 90-10 calculation. 34 C.F.R. § 600.5 (d)(3)(i).

2. Other than the passing reference, in the 1999 preamble to the 90-10 regulations, that proceeds of sales of institutional loans to unrelated parties can be included in the 90-10 regulation, there was no guidance from the DOE to institutions as to the conditions and circumstances under which proceeds of sales of student loan receivables can be included in the 90-10 calculation.

3. When Star Upper Darby's 2003 and 2004 audited financial statements were filed with the DOE, it did not reject or question the 90-10 calculations in those audits. Star Upper Darby reasonably relied on the DOE's acceptance of these audits and made decisions about its business, including to whom it could properly sell tuition receivables.

4. Exclusion of the United payments from Star Upper Darby's 2003 and 2004 90-10 calculations at this late date, based on the retroactive application of a previously unpublished interpretation of the regulation, would deprive Star Upper Darby of any compensation for substantial educational services it provided years ago to hundreds of students, all on the basis of a standard of conduct about which it was not given notice during the years in question. This is inequitable and punitive.

5. Financial Accounting Standards Board ("FASB") No. 57, paragraph 3, does not mandate or support the conclusion that the United loan purchase payments must be excluded from Star Upper Darby's 90-10 calculations. Instead, FASB 57 merely provides that transactions with related parties cannot be presumed to be on an arms length basis in the absence of substantiation. For purposes of inclusion of loan proceeds in the 90-10 calculation, the regulation does not require a showing that the amount paid for purchase of a loan is an "arms length" amount, but rather only that the payment was made by a party outside of the institution. Moreover, the substantial discounts that United received on the purchase price for performing loans (ranging from 24% to 40%) is evidence that United applied a standard market credit analysis in setting a price for the loans.

In light of all of the facts and legal factors outlined above, we strongly believe that the only reasonable and fair application of the provisions of the 90-10 statute and regulation to Star

Upper Darby's 90-10 ratios for fiscal 2003 and fiscal 2004 is to keep the United receivable payments in the 90-10 calculations for those fiscal years.

IV. The Gifts Findings

The Draft Report states that $70,925 of tuition payments booked by Star Upper Darby during fiscal year 2005 should be removed from the 90-10 calculation for that fiscal year, because these payments were made by the four shareholders of Nerak on behalf of various former Star Upper Darby students who had unpaid account balances with the institution. The Draft Report concludes that these gifted funds must be excluded from the 90-10 calculation for fiscal 2005 because they did not come from "sources independent of the institution" and the preamble to the 1999 regulations stated that "funds donated ...by related parties may not count for purposes of the 90/10 calculation." DR at 9.

There is no dispute that, if these gifted funds are kept in Star Upper Darby's fiscal 2005 90-10 calculation, the institutions' Title IV percentage is below 90.1%. And, as with the United purchases of institutional loans, there is no dispute that these cash gifts were actually made to Star Upper Darby by the four Nerak shareholders – (**Names Redacted**) – and were made by them from their personal resources. These cash gift payments were reported in the institution's deposit logs, which were reviewed by OIG during its audit work. Every month during fiscal 2005, the Nerak shareholders withdrew cash from their personal savings and checking accounts and pooled their funds to make gifts on behalf of various former Star Upper Darby students with unpaid account balances. Students selected included graduates and dropped students for whom a considerable amount of awarded Title IV aid was returned by Star under the requirements of the federal regulations.

Star continues to believe that the gifted funds qualify for inclusion in the 90-10 calculation for fiscal 2005, since the payments represent funds from sources outside the institution that were paid to cover tuition charges for students, similar to a gift from a family member or a stipend or grant from a state agency or external scholarship fund. The gifted funds here did not come from institutional revenues or bank accounts, but instead came from the after-tax resources of the four Nerak shareholders. While the four shareholders are admittedly related to the institution through their share of ownership and a quoted passage in the 1999 preamble declares that gifts made by related parties must be excluded, there is no such prohibition in the statute or regulation. We believe that the language of the statute and the regulation control here and that tuition payments by an institution's shareholders from their personal resources represent an inflow of revenues from outside of the institution and funds from a source other than the Title IV programs. Accordingly, we urge OIG to rescind its conclusion about exclusion of these cash payments and to instead conclude that these amounts should be kept in the 90-10 calculation for fiscal 2005.

V. The Fees Finding

The Draft Report states that application fee payments totaling $48,900 in fiscal 2004 and $54,200 in fiscal 2005 were made by students and included by Star Upper Darby in the denominator (all tuition and related charges revenue), but not the numerator, of the 90-10 calculations for those fiscal years. According to the Draft Report, all of these fee payments also should have been included in the numerator of the 90-10 calculation, apparently on the basis that

the funds used to pay these fees must be presumed to come from Title IV aid awarded to students, since the total of all awarded Title IV aid for these students equaled or exceeded the total of tuition and institutional charges for the students in question and the 90-10 regulation, 34 C.F.R. § 600.5 (e) (2), states that schools must presume that all Title IV funds disbursed were applied to institutional charges, even if the students made cash payments from their own resources.

Star's initial approach with the application fees was to not include them in either the numerator or the denominator of the 90-10 calculation, because Star mistakenly believed that the fees should be excluded completely, since they are not tuition. Apparently, as a result of a mathematical process error, however, the fees were left in the denominator but removed from the numerator. Upon reviewing the Draft Report's discussion of the fees and the provisions of the refund regulation, 34 C.F.R. § 600.5 (d)(1), Star now recognizes and agrees that application fees are identified as an express revenue component to be included in the 90-10 calculation, both in the denominator and the numerator. However, Star believes that not all of the $48,900 of fees paid in fiscal 2004 and the $54, 200 of fees paid in fiscal 2005 should be included in the numerator, because some students paid the $100 institutional application up front, prior to any Title IV disbursement, with cash payments made from their resources or those of their family. The amount of fees paid directly by students from resources other than Title IV was $3,390 in fiscal 2004 and $1,803 in fiscal 2005.

As noted above in Part II, in each of the years at issue here, Star Upper Darby made substantial payments of Title IV funds directly to students, which reflected, in part, the fact that the students had paid application fees and, in some cases, a portion of their tuition charges, from their personal resources. The broad presumption to the contrary in the 90-10 regulation is plainly inconsistent with the stated premise of the 90-10 statute, which is that institutions offering education of reasonable quality will be able to attract tuition payments from sources other than the Title IV programs. In short, the "presumption" provision of the 90-10 regulation is contrary to law and, therefore, should not be followed and applied to Star Upper Darby's 90-10 calculations for fiscal 2004 and 2005.

In conclusion, $3,390 of fee income for fiscal 2004 and $1,803 of fee income for fiscal 2005, while properly included in the denominator, should not be included in the numerator of the 90-10 calculations since these amounts came from student resources and the OIG should revise its conclusion accordingly concerning the fee payments.

VI. OIG Recommendations on Liability Calculation & Eligibility Impact

If the Sales, Gifts and Fees revenues are included in the 90-10 calculation in the manner outlined above, then Star Upper Darby complied with the 90-10 Rule for fiscal years 2003, 2004 and 2005, just as it reported in each of its timely filed audited financial statements for those fiscal years – audits to which DOE never objected. If OIG, however, should continue to maintain any of the positions outlined in the Draft Report concerning the Sales Finding, the Gifts Finding and the Fees Finding, then, based on those revenue determinations, Star Upper Darby's revenues from the Title IV programs likely will exceed 90.0% for one or more of fiscal years 2003, 2004 and 2005.

The Draft Report, proceeding on the basis of these underlying revenue determinations, reaches the overall conclusion that Star Upper Darby failed to satisfy the 90-10 Rule in each of fiscal 2003, 2004 and 2005 and that such failures amounted to violations of a provision of Star Upper Darby's program participation agreement. And, based on this overall conclusion, the Draft Report makes the following recommendations to the DOE:

(1) Require Star Upper Darby to pay back to the Title IV programs and lenders *all* of the Title IV aid disbursed by the institution in each fiscal year following a failing 90-10 year, i.e., fiscal 2004, 2005 and 2006;

(2) Terminate the existing Title IV eligibility of Star Upper Darby; and

(3) Require Star Upper Darby to pay back to the Title IV programs and lenders *all* of the Title IV aid disbursed by the institution in fiscal 2006 and later time periods if Star Upper Darby cannot demonstrate that its Title IV aid percentage was not above 90.0% in fiscal 2006. (DR at 13-14)

Star strongly believes that the Draft Report's underlying conclusions on the Sales Findings, the Gifts Finding and the Fees Finding are in error and should be rescinded and revised for the reasons discussed above. But, even if OIG should decline to revise any one of more of those underlying determinations, such that Star Upper Darby's Title IV aid percentage is over 90.0% for any of the fiscal years 2003, 2004 and 2005, the Draft Report's Recommendations (1) to (3) are not consistent with DOE regulations and practice.

A. Liability for Title IV Funds

With regard to Recommendations 1 and 3 regarding liability for Title IV aid disbursed during ineligible years (following a fiscal year failing the 90/10 test), DOE requires payment in full of grant funds but only the so-called 'loss' portion of loan funds. Under DOE's long standing practice, summarized in (**Name Redacted**) July 17, 1996 memorandum (see enclosure 1), an institution that disbursed loan funds to ineligible students, programs or locations is obligated to repay only the 'loss' amount which is equivalent to the institution's historical cohort default rate percentage (for the time period covered by the finding) multiplied by total loan disbursements, plus an amount to cover subsidies and interest paid to lenders on defaulted subsidized loans. Thus, the Draft Report's Recommendations (1) and (3), proposing that Star be required to pay back 100% of all Title IV aid, are in error and must be revised to be consistent with DOE practice on recovery of loan funds.

In addition to the loan liability adjustment required by the loan loss formula, the amount of any liability that Star might have for Title IV funds disbursed in fiscal 2004, 2005 and 2006 would also have to be reduced by the amount of the 'teachout' credit to which Star Upper Darby would be entitled under 34 C.F.R. § 668.26 for previously awarded grant funds earned by students in the payment period following loss of institutional eligibility and for previously awarded loan funds earned by students in the loan period following loss of institutional eligibility. *See* **2007-08 Federal Student Aid Handbook**, Vol. 1, Chap. 12, at pp 2-166 to 2-167 (enclosure 2). Star has not calculated the amount of the teachout credit, but could do so in the event that the DOE were to make a final audit determination that Star Upper Darby failed to satisfy the 90-10 Rule in any of the fiscal years 2003, 2004 or 2005.

B. Title IV Eligibility

The Draft Report's Recommendation (2) asks the DOE to terminate the existing Title IV eligibility of Star Upper Darby based on the Draft Report's conclusion that Star Upper Darby failed the 90-10 Rule in fiscal years 2003, 2004 and 2005. But the 90-10 regulation, 34 C.F.R., § 600.5 (g), only requires an institution failing the 90-10 Rule in any given year, to be excluded for one subsequent year (the "Exclusion Year"), after which the institution may apply to be readmitted to the Title IV programs if it meets the 90-10 Rule during the Exclusion Year and satisfies institutional eligibility requirements, and this is exactly the approach which the DOE has followed with institutions that have lost Title IV eligibility due to failing the 90-10 Rule. Thus, even if the Draft Report's conclusions that Star Upper Darby failed the 90-10 Rule in each of fiscal years 2003, 2004 and 2005 were valid and were accepted by the DOE, if Star Upper Darby did not receive more than 90.0% of its tuition revenues in Fiscal 2006 and it otherwise continues to meet institutional eligibility requirements, there is no basis for terminating the institution's existing Title IV eligibility.

OIG did not audit or otherwise review Star Upper Darby's Title IV funds percentage for fiscal years 2006 and 2007, even though Star invited the OIG to do so and Star also submitted a revenue breakdown to the OIG for each of those years. Star is confident that the institution did not receive more than 90.0 % of its tuition revenues from Title IV program funds during fiscal years 2006 and 2007, since the institution had no sales of institutional loans to United or gifts from shareholders during those years and instead enjoyed increased student referrals from Title III state workforce agency and also had Sallie Mae loans available to students during those years. This 90-10 compliance, coupled with Star Upper Darby's continuing satisfaction of all other Title IV eligibility conditions, qualifies the institution for renewal of its Title IV eligibility in the year immediately following the last Exclusion Year and the continuation thereafter of Title IV eligibility and participation. Accordingly, the Draft Report's Recommendation (2) should be rescinded completely, as there is no basis for recommending the termination of the existing Title IV eligibility of Star Upper Darby.

VII. The 90 Percentage Statute, As Applied, is Unconstitutional

The 90-10 statute, 20 U.S.C. § 1002 (b)(1)(F), both on its face and as interpreted and applied in the Draft Report, violates the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution. As Congressmen (**Names Redacted**) observed in an April 30, 2004 letter (see enclosure 3), "the '90-10' ratio is completely arbitrary" and "fundamentally unfair to some of our nation's neediest students and the schools that serve them." *Id.* at 2 & 4. The statute is irrational, discriminatory and unfair in its design and application and does not – and cannot ever – achieve its announced goal of assuring institutional quality. The rule is not designed to account for factors that have nothing to do with academic quality but can control whether or not more than 90% of an institution's tuition revenues come from Title IV aid, such as the state in which an institution is located, the length and costs of its programs, the income level of its students, and the extent to which the institution's programs involve revenue generating services to the public.

Some institutions, regardless of the quality of their programs, can assure that they receive no more than 90% of their tuition revenues from the Title IV programs simply as a result of being in a state where substantial state aid is available to their students or as a result of

offering programs that have a clinic component – such as a beauty school salon floor – which generates revenue from services offered to public. But other institutions, like Star Upper Darby, though they offer high quality academic programs, will struggle or fail to keep their percentage of Title IV aid at or below 90.0% because they are in states where little or no state aid is available, they offer programs not involving any revenue generating services for the public, or all of their programs are low priced non-degree programs and the schools are based in urban areas where they serve low income minority students who qualify for Title IV aid that in most cases exceeds their tuition charges. This is evidenced by the large Title IV credit balances paid to students, as noted in Part II above.

The 90-10 Rule, thus, effectively penalizes for-profit institutions like Star Upper Darby, which choose to locate their campuses in low income urban areas and to offer short non-degree skills programs in order to conveniently serve low income students who need to gain vocational skills to improve their wage earning capability. Indeed, the best approach that an institution like Star Upper Darby could use to assure compliance with the 90-10 Rule would be to move its campus away from low income urban areas or to increase its program tuition to the point where such low income students cannot pay 90% or more of their tuition and fees with Title IV aid. Neither of these alternatives serves the best interests of students or fulfills the announced goal of the 90-10 statute. In short, this statute is inherently and irreparably flawed. It discriminates against poor students – on the basis of their indigency and residential patterns associated with their indigency – by driving for-profit postsecondary educational institutions away from urban areas and other economically depressed areas to suburban areas less convenient to poor students but accessible to middle class students who do not qualify for as much Title IV aid. Low income minority students are harmed by the 90-10 Rule, while middle and upper class students suffer no harm and instead benefit by having a greater number of convenient higher education choices. This rule has no redeeming value and is unconstitutional because it discriminates based on income class and is not rationally related to its stated purpose.

The sad legacy of the 90-10 Rule is that, instead of helping students by supposedly weeding out illegitimate for-profit institutions which waste federal funds and do not deliver meaningful educational services, the Rule here is threatening an institution that has been effectively serving poor citizens in Pennsylvania and New Jersey with affordable and relevant educational training programs, as attested by completion rates averaging over 60% and placement rates averaging over 70%, which exceed the outcomes achieved by many public institutions. And the reason Star Upper Darby has struggled with the mandate that no more than 90.0% of its tuition revenue come from Title IV aid is exactly because it has chosen to serve the population most in need of Title IV aid and to serve those neediest of students with affordable programs whose tuition could be paid almost completely with Title IV aid. This story has been repeated with other institutions that are geographically located in areas where the poorest of the poor live, be that inner city neighborhoods or economically depressed areas like the decaying rust belt of some Midwest communities or the struggling agricultural areas of western Mississippi or southern Texas. Institutions that dare to serve the poorest of the poor, and to offer relevant skills training programs at prices which can be met almost entirely with Title IV aid, will face difficulty in meeting the 90-10 Rule, no matter how good the quality is of their programs, faculty and student services.

VIII. Conclusion

Thank you in advance for giving time and consideration to the facts and legal points outlined above. We believe that this response demonstrates that the Draft Report's findings and recommendations should be revised and that Star Upper Darby satisfied the 90 Percent Rule or 90/10 Rule in fiscal years 2003, 2004 and 2005, and we are prepared to answer any questions you may have concerning the foregoing facts and information.

Very truly yours,
Star Technical Institute – Upper Darby

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