ITT Closure Highlights Importance of Compliance

By Don Sutherland

Last week, ITT Educational Services, Inc., a for-profit higher education institution with some 8,000 employees and 45,000 students announced that it "will discontinue academic operations at all of its ITT Technical Institutes permanently after approximately 50 years of continuous service." The institution blamed the Department of Education's increasing sanctions for that outcome and argued that it had no ability to "pursue our right to due process."

Those arguments will likely reverberate through the Higher Education environment and possibly the political landscape during this Presidential election year. This blog takes no position on the merit of ITT's arguments in what is a tragic outcome for tens of thousands of students and thousands of employees.

Instead, this blog's focus concerns what led to this ultimate outcome and whether there are lessons for other institutions. For that information, one can access ITT Educational Services' annual 10-K reports, as publicly-traded companies are required to file such reports with the Securities and Exchange Commission (SEC). The company's FY 2015 10-K report states:

One of the ED's [U.S. Department of Education] *regulations applicable to our institutions is that each institution must submit to the ED on an annual basis its audited, consolidated financial statements and a compliance audit of the institution's administration of the Title IV Programs in which it participates ("Compliance Audit"). The financial statements and Compliance Audit must cover one fiscal year and must be submitted to the ED within six months after the end of the fiscal year. Our institutions did not submit their 2013 audited consolidated financial statements and Compliance Audits to the ED by June 30, 2014 and, as a result, the ED determined in August 2014 that our institutions were not financially responsible…*

This failure led to a range of actions from the Department of Education, including placing ITT on heightened cash monitoring. It also triggered a response from the institution's accrediting-related responses. An SEC action was also initiated, leading to increased reporting requirements from the Department of Education in spring 2015.

In its 10-K report, ITT explained of these new reporting requirements, "Although we have submitted these reports to the ED to date, we cannot assure you that we will be able to continue to submit these reports to the ED according to its schedule."

The 10-K report continued, "On October 19, 2015, we received a letter from the ED identifying additional procedures that we are required to implement as a result of the identification of past deficiencies," while adding, "These additional procedures have resulted in the delay of our receipt of Title IV Program funds."

Finally, the report foreshadowed a possible institutional decision to close. It warned:

Any significant delay in our institutions' receipt of Title IV Program funds could materially adversely affect our financial condition, results of operations and cash flows, and could cause us *to be in default of the Financing Agreement… Depending on the length of the delay, we cannot assure you that we would be able to continue to operate our business in such an event.*

The event that led to what precipitated a cycle of increasing sanctions and reporting requirements is covered in both the Middle States Commission on Higher Education's (MSCHE) Requirements of Affiliation and accreditation standards.

Requirement of Affiliation #11 states, "…The institution demonstrates a record of responsible fiscal management, has a prepared budget for the current year, and undergoes an external financial audit on an annual basis."

Standard II, which declares that an institution demonstrates "compliance with all applicable federal, state, and Commission reporting policies, regulations, and requirements…"

Standard VI, which states that an institution undergoes "an annual independent audit confirming financial viability with evidence of follow-up on any concerns cited I the audit's accompanying management letter…"

Standard VII, which calls for a "legally constituted governing body that…plays a basic policy-making role in financial affairs to ensure integrity and strong financial management. This may include a timely review of audited financial statements…"

In conclusion, even if the Department of Education had not initiated the round of sanctions resulting from ITT's failure to submit its 2013 audited consolidated financial statements, an institution in the MSCHE region would very likely face significant sanctions from its accreditor for such an event. Such statements are vital, as they convey information as to whether an institution has the financial viability to carry out its educational mission and deliver academic services to its students.