

CAREER EDUCATION CORP  
Form 10-Q  
May 08, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

(Mark one)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2014**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_**

**Commission File Number: 0-23245**

**CAREER EDUCATION CORPORATION**  
**(Exact name of registrant as specified in its charter)**

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**36-3932190**  
(I.R.S. Employer  
Identification No.)

**231 N. Martingale Road**

**Schaumburg, Illinois**  
(Address of principal executive offices)

**60173**  
(Zip Code)

**Registrant's telephone number, including area code: (847) 781-3600**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company, as defined in Rule 12b-2 of the Exchange Act. Yes  No

Number of shares of registrant's common stock, par value \$0.01, outstanding as of April 30, 2014: 67,222,997

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**CAREER EDUCATION CORPORATION**

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**Table of Contents****CAREER EDUCATION CORPORATION AND SUBSIDIARIES****UNAUDITED CONSOLIDATED BALANCE SHEETS****(In thousands, except share and per share amounts)**

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents, unrestricted	\$ 264,188	\$ 318,761
Restricted cash	12,948	12,564
Short-term investments	38,326	31,592
Total cash and cash equivalents and short-term investments	315,462	362,917
Student receivables, net of allowance for doubtful accounts of \$19,752 and \$21,070 as of March 31, 2014 and December 31, 2013, respectively	31,582	34,498
Receivables, other, net	18,331	27,437
Prepaid expenses	20,328	20,218
Inventories	6,329	6,723
Deferred income tax assets, net	3,606	3,606
Other current assets	4,492	3,468
Assets of discontinued operations	523	1,150
Total current assets	400,653	460,017
<b>NON-CURRENT ASSETS:</b>		
Property and equipment, net	170,573	182,000
Goodwill	87,356	87,356
Intangible assets, net	39,850	40,117
Student receivables, net of allowance for doubtful accounts of \$6,011 and \$6,883 as of March 31, 2014 and December 31, 2013, respectively	4,758	5,204
Deferred income tax assets, net	10,644	10,644
Other assets, net	26,258	17,853
Assets of discontinued operations	1,406	1,854
<b>TOTAL ASSETS</b>	<b>\$ 741,498</b>	<b>\$ 805,045</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 29,640	\$ 24,615
Accrued expenses:		
Payroll and related benefits	31,198	34,172
Advertising and production costs	22,297	17,599
Income taxes	603	14,994
Other	51,039	41,083

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Deferred tuition revenue	55,251	60,914
Liabilities of discontinued operations	15,418	14,055
Total current liabilities	205,446	207,432
<b>NON-CURRENT LIABILITIES:</b>		
Deferred rent obligations	78,104	80,496
Other liabilities	27,593	27,619
Liabilities of discontinued operations	32,225	34,114
Total non-current liabilities	137,922	142,229
<b>STOCKHOLDERS EQUITY:</b>		
Preferred stock, \$0.01 par value; 1,000,000 shares authorized; none issued or outstanding		
Common stock, \$0.01 par value; 300,000,000 shares authorized; 82,001,778 and 81,889,907 shares issued, 67,196,127 and 67,170,522 shares outstanding as of March 31, 2014 and December 31, 2013, respectively	820	819
Additional paid-in capital	602,440	600,904
Accumulated other comprehensive loss	(531)	(503)
Retained earnings	10,515	68,658
Cost of 14,805,651 and 14,719,385 shares in treasury as of March 31, 2014 and December 31, 2013, respectively	(215,114)	(214,494)
Total stockholders equity	398,130	455,384
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 741,498</b>	<b>\$ 805,045</b>

The accompanying notes are an integral part of these unaudited consolidated financial statements.

Table of Contents**CAREER EDUCATION CORPORATION AND SUBSIDIARIES****UNAUDITED CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS****(In thousands, except per share amounts)**

	<b>For the Quarter Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>REVENUE:</b>		
Tuition and registration fees	\$ 240,071	\$ 279,910
Other	3,034	4,540
Total revenue	243,105	284,450
<b>OPERATING EXPENSES:</b>		
Educational services and facilities	86,078	102,757
General and administrative	189,780	189,597
Depreciation and amortization	15,052	16,969
Asset impairment	67	157
Total operating expenses	290,977	309,480
Operating loss	(47,872)	(25,030)
<b>OTHER INCOME (EXPENSE):</b>		
Interest income	106	245
Interest expense	(81)	(706)
Loss on sale of business		(6,712)
Miscellaneous income	622	7
Total other income (expense)	647	(7,166)
<b>PRETAX LOSS</b>	(47,225)	(32,196)
Provision for (benefit from) income taxes	220	(12,402)
<b>LOSS FROM CONTINUING OPERATIONS</b>	(47,445)	(19,794)
<b>(LOSS) INCOME FROM DISCONTINUED OPERATIONS, net of tax</b>	(10,698)	4,591
<b>NET LOSS</b>	(58,143)	(15,203)
<b>OTHER COMPREHENSIVE LOSS, net of tax:</b>		
Foreign currency translation adjustments		(1,743)
Unrealized (losses) gains on investments	(28)	1

Total other comprehensive loss	(28)	(1,742)
<b>COMPREHENSIVE LOSS</b>	<b>\$ (58,171)</b>	<b>\$ (16,945)</b>
<b>NET LOSS PER SHARE BASIC and DILUTED:</b>		
Loss from continuing operations	\$ (0.71)	\$ (0.30)
(Loss) income from discontinued operations	(0.16)	0.07
Net loss per share	\$ (0.87)	\$ (0.23)
<b>WEIGHTED AVERAGE SHARES OUTSTANDING:</b>		
Basic and Diluted	66,994	66,428

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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**CAREER EDUCATION CORPORATION AND SUBSIDIARIES**  
**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

	<b>For the Quarter Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (58,143)	\$ (15,203)
Adjustments to reconcile net loss to net cash used in operating activities:		
Asset impairment	67	157
Depreciation and amortization expense	15,431	19,295
Bad debt expense	5,852	6,702
Compensation expense related to share-based awards	1,341	1,775
Loss on sale of business		6,712
Loss on disposition of property and equipment	26	94
Changes in operating assets and liabilities	6	(33,729)
Net cash used in operating activities	(35,420)	(14,197)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of available-for-sale investments	(29,810)	(13,540)
Sales of available-for-sale investments	14,320	13,465
Purchases of property and equipment	(3,468)	(4,077)
Payments of cash upon sale of business		(1,947)
Other		(1)
Net cash used in investing activities	(18,958)	(6,100)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Issuance of common stock	196	304
Payment on borrowings		(80,000)
Change in restricted cash	(384)	86,470
Payments of capital lease obligations		(74)
Net cash (used in) provided by financing activities	(188)	6,700
<b>EFFECT OF FOREIGN CURRENCY EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS:</b>		
	10	(3,194)
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	(54,556)	(16,791)
<b>DISCONTINUED OPERATIONS CASH ACTIVITY INCLUDED ABOVE:</b>		
Add: Cash balance of discontinued operations, beginning of the period	182	127,925



Less: Cash balance of discontinued operations, end of the period	199	114,428
<b>CASH AND CASH EQUIVALENTS, beginning of the period</b>	318,761	112,697
<b>CASH AND CASH EQUIVALENTS, end of the period</b>	<b>\$ 264,188</b>	<b>\$ 109,403</b>

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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**CAREER EDUCATION CORPORATION AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**1. DESCRIPTION OF THE COMPANY**

The colleges, institutions and universities that are part of the Career Education Corporation ( CEC ) family offer high-quality education to a diverse student population in a variety of career-oriented disciplines through online, on-ground and hybrid learning program offerings. In addition to its online offerings, Career Education serves students from campuses throughout the United States offering programs that lead to doctoral, master s, bachelor s and associate degrees, as well as to diplomas and certificates.

Our institutions include both universities that provide degree programs through the master or doctoral level and colleges that provide programs through the associate and bachelor level. The University group includes American InterContinental University ( AIU ) and Colorado Technical University ( CTU ) predominantly serving students online with career-focused degree programs that meet the educational demands of today s busy adults. The Career Schools group offers career-centered education primarily through ground-based campuses and includes Briarcliffe College, Brooks Institute, Harrington College of Design, Le Cordon Bleu North America ( LCB ), Missouri College and Sanford-Brown Institutes and Colleges ( SBI and SBC, respectively). Through our colleges, institutions and universities, we are committed to providing high-quality education, enabling students to graduate and pursue rewarding career opportunities.

A detailed listing of individual campus locations and web links to Career Education s colleges, institutions and universities can be found at [www.careered.com](http://www.careered.com).

As used in this Quarterly Report on Form 10-Q, the terms we, us, our, the Company and CEC refer to Career Education Corporation and our wholly-owned subsidiaries. The terms college, institution and university refer to an individual, branded, proprietary educational institution, owned by us and includes its campus locations. The term campus refers to an individual main or branch campus operated by one of our colleges, institutions or universities.

**2. BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ( GAAP ) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the financial statements do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments, including normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the quarter ended March 31, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

The unaudited consolidated financial statements presented herein include the accounts of CEC and our wholly-owned subsidiaries (collectively CEC ). All intercompany transactions and balances have been eliminated.

Effective January 2014, we have changed our segment reporting to align with the manner in which we are now managing the business. Our reportable segments are: CTU, AIU (comprises University Schools); Career Colleges, Culinary Arts (comprises Career Schools); and Transitional Schools. Our Career Colleges reporting segment is a combination of our previously reported Health Education and Design & Technology segments. These were combined as a part of our overall brand consolidation strategy. Campuses included in our Transitional Schools segment are

currently being taught out and no longer enroll new students. These campuses employ a gradual teach-out process, enabling them to continue to operate while current students complete their course of study. The results of operations for campuses within the Transitional Schools segment will be reported within continuing operations for all periods presented until they complete their teach-out. As campuses within Transitional Schools cease operations, the results of operation for all periods presented will be reflected within discontinued operations. During

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the first quarter of 2014, the Company completed the teach-out of the following Sanford-Brown campuses: Austin, Collinsville, Cranston, Dearborn, Grand Rapids, Indianapolis, Portland, Tinley Park and Trevoise. As a result, all current and prior periods reflect these campuses as components of discontinued operations. All prior period results have been recast to reflect our reporting segments on a comparable basis.

In the fourth quarter of 2013, we completed the sale of our International Segment. Accordingly, the results of operations of the International Segment are reported within discontinued operations. Prior period financial statements and the related notes herein, including segment reporting, have been recast to include the results of operations and financial condition of the International Segment as a component of discontinued operations. See Note 4 Discontinued Operations of the notes to our unaudited consolidated financial statements.

### **3. RECENT ACCOUNTING PRONOUNCEMENTS**

In April 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. This ASU limits discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results. In addition, the amendments in this ASU require expanded disclosures for discontinued operations as well as for disposals that do not qualify as discontinued operations. For public entities, ASU 2014-08 is effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2014. Early adoption is permitted for disposals that have not been reported in financial statements previously issued. We are currently evaluating the impact that the adoption of ASU 2014-08 will have on our financial condition, results of operations and disclosures.

We have evaluated and adopted the guidance of the following ASUs issued by the FASB in 2013; adopting these ASUs did not materially impact the presentation of our financial condition, results of operations and disclosures:

ASU No. 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* issued in July 2013. ASU 2013-11 standardizes the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists; it does not require new recurring disclosures. ASU 2013-11 requires that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward unless specific criteria exist, in which case the unrecognized tax benefit should be presented as a liability and should not be combined with deferred tax assets.

ASU No. 2013-05, *Foreign Currency Matters (Topic 830): Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity* issued in March 2013. ASU 2013-05 provides guidance on releasing cumulative translation adjustments ( CTA ) when an entity ceases to have a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity, and also provides guidance on releasing CTA in partial sales of equity method investments and in step acquisitions.

ASU No. 2013-04, *Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date* issued in February 2013. The guidance in ASU 2013-04 requires entities to measure obligations resulting from joint and several liability arrangements, for which the total obligation amount is fixed at the reporting date, as the sum of the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and any additional amount it expects to pay on behalf of its co-obligors. ASU 2013-04 also specifies disclosure requirements.

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As of March 31, 2014, the results of operations for campuses that have ceased operations or schools that were sold, and are considered distinct operations as defined under FASB ASC Topic 205 *Presentation of Financial Statements*, are presented within discontinued operations. During the first quarter of 2014, we completed the teach-out of nine campuses (see Note 2, *Basis of Presentation* of the notes to our unaudited consolidated financial statements). All current and prior period financial statements include the results of operations and financial position for these campuses as components of discontinued operations.

**Results of Discontinued Operations**

The summary of unaudited results of operations for our discontinued operations for the quarters ended March 31, 2014 and 2013 were as follows (dollars in thousands):

	<b>For the Quarter Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Revenue	\$ 274	\$ 56,060
Pretax (loss) income	\$ (10,698)	\$ 5,340
Income tax provision <sup>(1)</sup>		749
(Loss) income from discontinued operations, net of tax	\$ (10,698)	\$ 4,591

(1) Due to the valuation allowance against our net deferred taxes, there is no income tax benefit reported for the quarter ended March 31, 2014.

**Assets and Liabilities of Discontinued Operations**

Assets and liabilities of discontinued operations on our unaudited consolidated balance sheets as of March 31, 2014 and December 31, 2013 include the following (dollars in thousands):

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
<b>Assets:</b>		
Current assets:		
Cash and cash equivalents	\$ 199	\$ 182
Receivables, net	237	368
Other current assets	87	600
Total current assets	523	1,150

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<b>Non-current assets:</b>		
Property and equipment, net	12	396
Other assets, net	1,394	1,458
<b>Total assets of discontinued operations</b>	<b>\$ 1,929</b>	<b>\$ 3,004</b>
<b>Liabilities:</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 216	\$ 790
Deferred tuition revenue		217
Remaining lease obligations	15,202	13,048
Total current liabilities	15,418	14,055
Non-current liabilities:		
Remaining lease obligations	32,225	30,852
Other		3,262
<b>Total liabilities of discontinued operations</b>	<b>\$ 47,643</b>	<b>\$ 48,169</b>

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A number of the campuses that ceased operations have remaining lease obligations that expire over time with the latest expiration in 2020. A liability is recorded representing the fair value of the remaining lease obligation at the time the space is no longer being utilized. Changes in our future remaining lease obligations, which are reflected within current and non-current liabilities of discontinued operations on our unaudited consolidated balance sheets, for the quarters ended March 31, 2014 and 2013 were as follows (dollars in thousands):

	<b>Balance, Beginning of Period</b>	<b>Charges Incurred <sup>(1)</sup></b>	<b>Net Cash Payments</b>	<b>Other <sup>(2)</sup></b>	<b>Balance, End of Period</b>
For the quarter ended March 31, 2014	\$ 43,900	\$ 6,311	\$ (5,817)	\$ 3,033	\$ 47,427
For the quarter ended March 31, 2013	\$ 46,298	\$ (227)	\$ (2,294)	\$ (38)	\$ 43,739

(1) Includes charges for newly vacated spaces and subsequent adjustments for accretion, revised estimates and variances between estimated and actual charges, net of any reversals for terminated lease obligations.

(2) Includes existing prepaid rent and deferred rent liability balances for newly vacated spaces that are netted with the losses incurred in the period recorded.

**5. FINANCIAL INSTRUMENTS****Cash and Cash Equivalents and Investments**

Cash and cash equivalents from our continuing operations consist of the following as of March 31, 2014 and December 31, 2013 (dollars in thousands):

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Cash	\$ 175,739	\$ 155,756
Corporate bonds	1,006	
Money market funds	87,443	163,005
Cash and cash equivalents, unrestricted	264,188	318,761
Restricted cash	12,948	12,564
Total cash and cash equivalents	\$ 277,136	\$ 331,325

Restricted cash balances provide securitization for our outstanding letters of credit.

Investments from our continuing operations consist of the following as of March 31, 2014 and December 31, 2013 (dollars in thousands):



	<b>March 31, 2014</b>			
	<b>Gross Unrealized</b>			
	<b>Cost</b>	<b>Gain</b>	<b>(Loss)</b>	<b>Fair Value</b>
<b>Short-term investments (available for sale):</b>				
Commercial paper	\$ 15,641	\$	\$ (5)	\$ 15,636
Corporate bonds	5,443		(7)	5,436
U.S. Treasury bills	17,253	1		17,254
<b>Total short-term investments</b>	<b>38,337</b>	<b>1</b>	<b>(12)</b>	<b>38,326</b>
<b>Long-term investments (available for sale):</b>				
Corporate bonds	8,723		(17)	8,706
Municipal bond	7,850		(476)	7,374
<b>Total long-term investments</b>	<b>16,573</b>		<b>(493)</b>	<b>16,080</b>
<b>Total investments (available for sale)</b>	<b>\$ 54,910</b>	<b>\$ 1</b>	<b>\$ (505)</b>	<b>\$ 54,406</b>

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		December 31, 2013		
	Cost	Gross Unrealized Gain	(Loss)	Fair Value
Short-term investments (available for sale):				
U.S. Treasury bills	\$ 31,591	\$ 1	\$	\$ 31,592
Long-term investments (available for sale):				
Municipal bond	7,850		(476)	7,374
<b>Total investments (available for sale)</b>	<b>\$ 39,441</b>	<b>\$ 1</b>	<b>\$ (476)</b>	<b>\$ 38,966</b>

In the table above, unrealized holding gains/(losses) as of March 31, 2014 relate to short-term investments and our long term investment in corporate bonds that have been in a continuous unrealized gain/(loss) position for less than one year. The table also includes unrealized holding losses, greater than one year, that relate to our long-term investment in a municipal bond, which is an auction rate security ( ARS ). When evaluating our investments for possible impairment, we review factors such as the length of time and extent to which fair value has been less than the cost basis, the financial condition of the investee, and our ability and intent to hold the investment for a period of time that may be sufficient for anticipated recovery in fair value. The unrealized loss attributable to our municipal bond at March 31, 2014 is attributable to the continued lack of activity in the ARS market, exposing this investment to liquidity risk.

Our municipal bond is comprised of debt obligations issued by states, cities, counties and other governmental entities, which earn federally tax-exempt interest. Our investment in ARS has a stated term to maturity of greater than one year, and as such, we classify our investment in ARS as non-current on our unaudited consolidated balance sheets within other assets. Auctions can fail when the number of sellers of the security exceeds the buyers for that particular auction period. In the event that an auction fails, the interest rate resets at a rate based on a formula determined by the individual security. The ARS for which auctions have failed continues to accrue interest and is auctioned on a set interval until the auction succeeds, the issuer calls the security, or it matures. As of March 31, 2014, we have determined this investment is at risk for impairment due to the nature of the liquidity of the market over the past year. Cumulative unrealized losses as of March 31, 2014 amount to \$0.5 million and are reflected within accumulated other comprehensive loss as a component of stockholders equity. We believe this impairment is temporary, as we do not intend to sell the investment and it is unlikely we will be required to sell the investment before recovery of its amortized cost basis.

**Fair Value Measurements**

FASB ASC Topic 820 *Fair Value Measurements* establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets for identical assets or liabilities; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

As of March 31, 2014, we held investments that are required to be measured at fair value on a recurring basis. These investments (available-for-sale) consist of commercial paper, corporate bonds and U.S. treasury bills that are publicly traded and for which market prices are readily available, and our investment in a municipal bond. Available for sale securities included in Level 2 are estimated based on observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. As of March 31, 2014, we reclassified our investments in U.S. Treasury bills from Level 1 classification

to Level 2. The fair value for these investments was not based on identical assets as of March 31, 2014 which resulted in this reclassification. Our investment in a municipal bond is categorized as Level 3 and fair value is estimated utilizing a discounted cash flow analysis as of March 31, 2014 which considers, among other items, the collateralization underlying the security investment, the credit worthiness of the counterparty, the timing of expected future cash flows, and the expectation of the

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next time the security is expected to have a successful auction. The auction event for our municipal bond investment has failed for multiple years. This security was also compared, when possible, to other observable market data with similar characteristics.

Investments measured at fair value on a recurring basis subject to the disclosure requirements of FASB ASC Topic 820 *Fair Value Measurements* at March 31, 2014 and December 31, 2013 were as follows (dollars in thousands):

	As of March 31, 2014			Total
	Level 1	Level 2	Level 3	
Commercial paper	\$	\$ 15,636	\$	\$ 15,636
Corporate bonds		14,142		14,142
U.S. Treasury bills		17,254		17,254
Municipal bond			7,374	7,374
Totals	\$	\$ 47,032	\$ 7,374	\$ 54,406

	As of December 31, 2013			Total
	Level 1	Level 2	Level 3	
U.S. Treasury bills	\$ 31,592	\$	\$	\$ 31,592
Municipal bond			7,374	7,374
Totals	\$ 31,592	\$	\$ 7,374	\$ 38,966

The following table presents a rollforward of our assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in FASB ASC Topic 820 for the quarter ended March 31, 2014 (dollars in thousands):

Balance at December 31, 2013	\$ 7,374
Unrealized gain (loss)	
Balance at March 31, 2014	\$ 7,374

**Credit Agreement**

During the fourth quarter of 2013, we entered into a \$70.0 million Amended and Restated Credit Agreement (the Credit Agreement ) with BMO Harris Bank N.A., in its capacities as the initial lender and letter of credit issuer thereunder and the administrative agent for the lenders which from time to time may be parties to the Credit Agreement. The revolving credit facility under the Credit Agreement is scheduled to mature on June 30, 2016. As of March 31, 2014, there were no outstanding borrowings under the revolving credit facility.

**6. STUDENT RECEIVABLES**

Student receivables represent funds owed to us in exchange for the educational services provided to a student. Student receivables are reflected net of an allowance for doubtful accounts and net of deferred tuition revenue. Student receivables, net are reflected on our unaudited consolidated balance sheets as components of both current and non-current assets. We do not accrue interest on past due student receivables; interest is recorded only upon collection.

Generally, a student receivable balance is written off once it reaches greater than 90 days past due. Although we analyze past due receivables, it is not practical to provide an aging of our non-current student receivable balances as a result of the methodology utilized in determining our earned student receivable balances. Student receivables are recognized on our unaudited consolidated balance sheets as they are deemed earned over the course of a student's program and/or term, and therefore cash collections are not applied against specifically dated transactions.

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Our standard student receivable allowance estimation methodology considers a number of factors that, based on our collection experience, we believe have an impact on our repayment risk and ability to collect student receivables. Changes in the trends in any of these factors may impact our estimate of the allowance for doubtful accounts. These factors include, but are not limited to: internal repayment history, repayment practices of previous extended payment programs and information provided by a third-party institution who previously offered similar extended payment programs, changes in the current economic, legislative or regulatory environments and credit worthiness of our students. These factors are monitored and assessed on a regular basis. Overall, our allowance estimation process for student receivables is validated by trending analysis and comparing estimated and actual performance. The repayment risk associated with student receivables under extended payment plans is generally higher than those not related to extended payment plans; as such, the allowance for doubtful accounts for these student receivables as a percentage of outstanding student receivables is higher.

**Student Receivables Under Extended Payment Plans and Recourse Loan Agreements**

To assist students in completing their educational programs, we had previously provided extended payment plans to certain students and also had loan agreements with Sallie Mae and Stillwater National Bank and Trust Company ( Stillwater ) which required us to repurchase loans originated by them to our students after a certain period of time. We discontinued providing extended payment plans to students during the first quarter of 2011 and the recourse loan agreements with Sallie Mae and Stillwater ended in March 2008 and April 2007, respectively.

As of March 31, 2014 and December 31, 2013, the amount of non-current student receivables under these programs, net of allowance for doubtful accounts and net of deferred tuition revenue, was \$4.8 million and \$5.2 million, respectively.

**Student Receivables Valuation Allowance**

Changes in our current and non-current receivables allowance for the quarters ended March 31, 2014 and 2013 were as follows (dollars in thousands):

	<b>Balance, Beginning of Period</b>	<b>Charges to Expense <sup>(1)</sup></b>	<b>Amounts Written-off</b>	<b>Balance, End of Period</b>
For the quarter ended March 31, 2014	\$ 27,953	\$ 5,866	\$ (8,056)	\$ 25,763
For the quarter ended March 31, 2013	\$ 39,163	\$ 5,751	\$ (11,179)	\$ 33,735

(1) Charges to expense include an offset for recoveries of amounts previously written off of \$2.3 million and \$2.1 million for the quarters ended March 31, 2014 and 2013, respectively.

**Fair Value Measurements**

The carrying amount reported in our unaudited consolidated balance sheets for the current portion of student receivables approximates fair value because of the nature of these financial instruments as they generally have short

maturity periods. It is not practicable to estimate the fair value of the non-current portion of student receivables, since observable market data is not readily available, and no reasonable estimation methodology exists.

## **7. RESTRUCTURING CHARGES**

Reductions in force have been carried out related to the reorganization of our corporate and campus functions to better align with current total enrollments and decisions made in previous years to teach out a number of campuses, meaning gradually close the campuses through an orderly process. We anticipate that a majority of the campus closures will be completed by the third quarter of 2014.

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The following table details the changes in our accrual for severance and related costs associated with these restructuring events for our continuing operations during the quarters ended March 31, 2014 and 2013 (dollars in thousands):

	<b>Balance, Beginning of Period</b>	<b>Severance and related charges</b>	<b>Payments <sup>(1)</sup></b>	<b>Non-cash adjustments <sup>(2)</sup></b>	<b>Balance, End of Period</b>
For the quarter ended March 31, 2014	\$ 4,913	\$	\$ (593)	\$ (278)	\$ 4,042
For the quarter ended March 31, 2013	\$ 7,931	\$ 364	\$ (4,060)	\$ (73)	\$ 4,162

(1) Includes payments related to COBRA and outplacement services which are assumed to be completed by the third month following an employee's departure.

(2) Includes cancellations due to employee departures prior to agreed upon end dates, employee transfers to open positions within the organization and subsequent adjustments to severance and related costs.

The current portion of the accrual for severance and related charges was \$2.5 million and \$2.3 million as of March 31, 2014 and March 31, 2013, respectively, which is recorded within current accrued expenses payroll and related benefits; the long-term portion of \$1.5 million and \$1.9 million, respectively, is recorded within other non-current liabilities. In addition, as of March 31, 2014, we have accrued approximately \$1.4 million related to retention bonuses that have been offered to certain employees. These amounts will be recorded ratably over the period the employees are retained; \$0.3 million was recorded during the quarter ended March 31, 2014.

During the first quarter of 2014, nine of our campuses completed their teach-out activities, seven of the nine campuses had remaining lease obligations related to their facilities. The charge recorded during the current quarter related to these discontinued operations was approximately \$8.1 million, which represents the net present value of our remaining lease obligation less an estimated amount for sublease income and was recorded within loss from discontinued operations for the current quarter. A number of our teach-out campuses that have not yet closed will have remaining lease obligations following the eventual campus closure, with the longest lease term being through 2021. The total estimated charge related to the remaining lease obligation for these leases, once the campus completes the close process, and adjusted for possible lease buyouts and sublease assumptions is approximately \$20.0 to \$25.0 million. The amount related to each campus will be recorded at each campus closure date based on current estimates and assumptions related to the amount and timing of sublease income.

**8. COMMITMENTS AND CONTINGENCIES**

An accrual for estimated legal fees and settlements of \$28.9 million and \$20.3 million at March 31, 2014 and December 31, 2013, respectively, is presented within other current liabilities on our unaudited consolidated balance sheets.

We record a liability when we believe that it is both probable that a loss will be incurred and the amount of loss can be reasonably estimated. We evaluate, at least quarterly, developments in our legal matters that could affect the amount of liability that was previously accrued, and make adjustments as appropriate. Significant judgment is required to determine both probability and the estimated amount. We may be unable to estimate a possible loss or range of



possible loss due to various reasons, including, among others: (1) if the damages sought are indeterminate; (2) if the proceedings are in early stages; (3) if there is uncertainty as to the outcome of pending appeals, motions, or settlements; (4) if there are significant factual issues to be determined or resolved; and (5) if there are novel or unsettled legal theories presented. In such instances, there is considerable uncertainty regarding the ultimate resolution of such matters, including a possible eventual loss, if any.

**Litigation**

We are, or were, a party to the following legal proceedings that we consider to be outside the scope of ordinary routine litigation incidental to our business. Due to the inherent uncertainties of litigation, we cannot

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predict the ultimate outcome of these matters. An unfavorable outcome of any one or more of these matters could have a material adverse impact on our business, results of operations, cash flows and financial position.

***Securities Litigation***

*Ross, et al. v. Career Education Corporation, et al.* On January 13, 2012, a class action complaint was filed in the U.S. District Court for the Northern District of Illinois, naming the Company and various individuals as defendants and claiming that the defendants violated Section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act) by making material misstatements in and omitting material information from the Company's public disclosures concerning its campuses' job placement rates and its compliance with accreditation standards. The complaint further claimed that the individual defendants violated Section 20(a) of the Exchange Act by virtue of their positions as control persons of the Company. Plaintiff asked for unspecified amounts in damages, interest, and costs, as well as ancillary relief. On March 23, 2012, the Court appointed KBC Asset Management NV, the Oklahoma Police Pension & Retirement Systems, and the Oklahoma Law Enforcement Retirement System, as lead plaintiffs in the action. Lead plaintiffs subsequently filed an amended complaint, asserting the same claims alleged in the initial complaint and seeking damages on behalf of all persons who purchased the Company's common stock between February 19, 2009 and November 21, 2011 (the Class).

On June 12, 2013, the parties agreed to settle the Ross litigation, subject to final Court approval and settlement of certain shareholder derivative actions and subsequent related claims (the Derivative Settlements). As previously disclosed, the Derivative Settlements received Court approval and were dismissed with prejudice in the first quarter of 2014. Under the Derivative Settlements, the Company's directors' and officers' liability insurers have paid \$10.0 million towards the settlement of this litigation.

On November 6, 2013, the Court entered an order preliminarily approving the Ross settlement. On April 16, 2014, the Court finally approved the settlement and dismissed the action with prejudice. Pursuant to the terms of the Ross settlement agreement, the Class will receive a total of \$27.5 million in consideration of the proposed settlement and the parties will release all claims. The Company's directors' and officers' liability insurers paid \$22.5 million of the settlement amount, \$10.0 million of which was funded pursuant to the Derivative Settlements discussed above, and the Company paid the remaining \$5.0 million. However, the Company is seeking recovery of that amount from one of its insurers, Axis Insurance Company (Axis), but has not recorded a receivable for this additional amount as it is not deemed probable as of March 31, 2014. As described below, Axis is seeking a declaration of no coverage. In connection with the Ross settlement, the Company entered into an additional settlement on April 15, 2014 with certain members of the Class pursuant to which the Company expects to pay approximately \$3.8 million. The Company is seeking recovery of this amount from Axis.

*Axis Insurance Company v. Career Education Company, et al.* On December 11, 2013, Axis Insurance Company filed a declaratory judgment action in the Circuit Court of Cook County, Chancery Division, naming the Company and various individuals as defendants in connection with coverage for the recently settled securities class action and shareholder derivative actions. Axis seeks a declaration of no coverage. On March 11, 2014, the Company and the individual defendants responded to Axis's complaint and asserted counterclaims pursuant to which the Company claims approximately \$10.0 million in coverage. On April 22, 2014, Axis responded to the Company's counterclaims.

***Student Litigation***

*Abarca v. California Culinary Academy, Inc., et al.* (filed June 3, 2011; 115 plaintiffs); *Andrade, et al. v. California Culinary Academy, Inc., et al.* (filed June 15, 2011; 31 plaintiffs); *Aprieto, et al. v. California Culinary Academy* (filed August 12, 2011; five plaintiffs); *Coleman, et al. v. California Culinary Academy* (filed January 18, 2013; two

plaintiffs). These four actions are pending in the San Francisco County Superior Court and generally allege: fraud, constructive fraud, violation of the California Unfair Competition Law, violation of the California Consumer Legal Remedies Act, breach of contract and violation of the repealed California Education Code. Plaintiffs contend that California Culinary Academy ( CCA ) made a variety of misrepresentations to

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them, primarily oral, during the admissions process. The alleged misrepresentations relate generally to the school's reputation, the value of the education, the competitiveness of the admissions process, and the students' employment prospects upon graduation, including the accuracy of statistics published by CCA. The plaintiffs in these actions seek damages, including consequential damages, punitive damages and attorneys' fees.

All of the plaintiffs in these four actions either opted out of or did not fit the class definition in a previously settled class action captioned *Amador, et al. v. California Culinary Academy and Career Education Corporation; Adams, et al. v. California Culinary Academy and Career Education Corporation*. None of these four actions are being prosecuted as a class action. All of these cases have been deemed related and have been transferred to the same judge who handled the *Amador* case.

Currently there are 79 remaining plaintiffs who have not settled or dismissed their claims. CCA has filed answers to the complaints filed by the remaining 79 individual plaintiffs. The parties participated in a mediation session on April 2, 2014 at which the Company agreed to settle with 77 of the remaining plaintiffs. The Company has agreed to pay approximately \$2.2 million plus an as yet undetermined amount of attorneys' fees. Accordingly, for the quarter ended March 31, 2014, the Company has reserved \$3.0 million which is the current estimate of the total amount of the settlement and based on its assessment that the settlement is probable.

The parties have agreed to arbitrate one of the remaining cases and the other case will be set for trial at a later date.

Because of the many questions of fact and law that may arise in the future with respect to the two remaining cases, the outcome in those cases is uncertain. Accordingly, we have not recognized any future liability associated with these actions.

*Enea, et al. v. Career Education Corporation, California Culinary Academy, Inc., SLM Corporation, and Sallie Mae, Inc.* Plaintiffs filed this putative class action in the Superior Court State of California, County of San Francisco, on or about June 27, 2013. Plaintiffs allege that CCA materially misrepresented the placement rates of its graduates, falsely stated that admission to the culinary school was competitive and that the school had an excellent reputation among restaurants and other food service providers, represented that the culinary schools were well-regarded institutions producing skilled graduates who employers eagerly hired, and lied by telling students that the school provided graduates with career placement services for life. The plaintiffs or putative class members here co-signed the loans for students to attend CCA, some of whom were *Amador* class members. Plaintiffs seek restitution, damages, civil penalties and attorneys' fees.

Defendants filed a motion to dismiss and to strike class action allegations on October 31, 2013. A hearing on the motions was conducted on March 14, 2014. Thereafter, the Court issued two separate orders granting the motion to strike the class allegations and the motion to dismiss without leave to amend. Plaintiffs filed a motion seeking leave to file a third amended complaint and/or for reconsideration of the Court's orders.

Because of the many questions of fact and law that may arise in the future, the outcome of this legal proceeding is uncertain at this point. Based on information available to us at present, we cannot reasonably estimate a range of potential loss, if any, for this action because, among other things, our potential liability depends on whether a class is certified and, if so, the composition and size of any such class, as well as on an assessment of the appropriate measure of damages if we were to be found liable. Accordingly, we have not recognized any liability associated with this action.

*Surrett, et al. v. Western Culinary Institute, Ltd. and Career Education Corporation*. On March 5, 2008, a complaint was filed in Portland, Oregon in the Circuit Court of the State of Oregon in and for Multnomah County naming

Western Culinary Institute, Ltd. and the Company as defendants. Plaintiffs filed the complaint individually and as a putative class action and alleged two claims for equitable relief: violation of Oregon's Unlawful Trade Practices Act ( UTPA ) and unjust enrichment. Plaintiffs filed an amended complaint on April 10, 2008, which added two claims for money damages: fraud and breach of contract. Plaintiffs allege that Western Culinary Institute, Ltd. ( WCI ) made a variety of misrepresentations to them, relating generally to

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WCI's placement statistics, students' employment prospects upon graduation from WCI, the value and quality of an education at WCI, and the amount of tuition students could expect to pay as compared to salaries they could expect to earn after graduation. WCI subsequently moved to dismiss certain of plaintiffs' claims under Oregon's UTPA; that motion was granted on September 12, 2008. On February 5, 2010, the Court entered a formal Order granting class certification on part of plaintiff's UTPA and fraud claims purportedly based on omissions, denying certification of the rest of those claims and denying certification of the breach of contract and unjust enrichment claims. The class consists of students who enrolled at WCI between March 5, 2006 and March 1, 2010, excluding those who dropped out or were dismissed from the school for academic reasons.

Plaintiffs filed a Fifth Amended Complaint on December 7, 2010, which included individual and class allegations by Nathan Surret. Class notice was sent on April 22, 2011, and the opt-out period expired on June 20, 2011. The class consisted of approximately 2,600 members. They are seeking tuition refunds, interest and certain fees paid in connection with their enrollment at WCI.

On May 23, 2012, WCI filed a motion to compel arbitration of claims by 1,062 individual class members who signed enrollment agreements containing express class action waivers. The Court issued an Order denying the motion on July 27, 2012. On August 6, 2012, WCI filed an appeal from the Court's Order and on August 30, 2012, the Court of Appeals issued an Order granting WCI's motion to compel the trial court to cease exercising jurisdiction in the case. The oral argument on the appeal is set for May 9, 2014. All proceedings with the trial court have been stayed pending the outcome of the appeal.

Because of the many questions of fact and law that have already arisen and that may arise in the future, the outcome of this legal proceeding is uncertain at this point. Based on information available to us at present, we cannot reasonably estimate a range of potential loss, if any, for this action because of the inherent difficulty in assessing the appropriate measure of damages and the number of class members who might be entitled to recover damages, if we were to be found liable. Accordingly, we have not recognized any liability associated with this action.

*Vasquez, et al. v. California School of Culinary Arts, Inc. and Career Education Corporation.* On June 23, 2008, a putative class action lawsuit was filed in the Los Angeles County Superior Court entitled *Daniel Vasquez and Cherish Herndon v. California School of Culinary Arts, Inc. and Career Education Corporation*. The plaintiffs allege causes of action for fraud, constructive fraud, violation of the California Unfair Competition Law and violation of the California Consumer Legal Remedies Act. The plaintiffs allege improper conduct in connection with the admissions process during the alleged class period. The alleged class is defined as including all persons who purchased educational services from California School of Culinary Arts, Inc. (CSCA), or graduated from CSCA, within the limitations periods applicable to the alleged causes of action (including, without limitation, the period following the filing of the action). Defendants successfully demurred to the constructive fraud claim and the Court has dismissed it. Defendants also successfully demurred to plaintiffs' claims based on alleged violations of California's former Private Postsecondary and Vocational Educational Reform Act of 1989 (the Reform Act). Plaintiffs' motion for class certification was denied by the Court on March 6, 2012.

Plaintiffs' counsel have filed eight separate but related multiple plaintiff actions originally involving a total of approximately 1,000 former students entitled *Banks, et al. v. California School of Culinary Arts*; *Abrica v. California School of Culinary Arts*; *Aguilar, et al. v. California School of Culinary Arts*; *Alday v. California School of Culinary Arts*; *Ackerman, et al. v. California School of Culinary Arts*; *Arechiga, et al. v. California School of Culinary Arts*; *Anderson, et al. v. California School of Culinary Arts*; and *Allen v. California School of Culinary Arts*. All eight cases are pending in the Los Angeles County Superior Court and the allegations in these cases are essentially the same as those asserted in the *Vasquez* class action case. The individual plaintiffs in these cases seek compensatory and punitive damages, disgorgement and restitution of tuition monies received, attorneys' fees, costs and injunctive relief.

All of these cases have been deemed related to the Vasquez class action and therefore are pending before the same judge who is presiding over the Vasquez case.

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On June 15, 2012, pursuant to a stipulation by the parties, the plaintiffs filed a consolidated amended complaint in the *Vasquez* action consolidating all eight of the separate actions referenced above. The complaint was thereafter amended to add additional plaintiffs. As a result of these amendments, there were at one time approximately 1,438 plaintiffs, the majority of whom enrolled between 2003 and 2008 (about 10 of the plaintiffs enrolled in 2009 and 2010).

On June 22, 2012, defendants filed motions to compel arbitration of plaintiffs' claims. On August 10, 2012, the Court granted the motions with respect to approximately 54 plaintiffs. Nine arbitration demands were filed before the American Arbitration Association, one of which was tried to a final award and eight of which were settled. The remaining plaintiffs' claims were settled prior to arbitration demands being filed. The total liability for all of these claims was an immaterial amount. Following the resolution of these claims, other settlements, and the voluntary dismissal of certain claims, there are approximately 1,047 remaining plaintiffs in the consolidated action.

The Company and plaintiffs' counsel have executed an agreement regarding the framework for individual settlements with approximately 950 of the remaining individual plaintiffs. Pursuant to this settlement arrangement, defendants will pay a maximum of \$17.5 million in the aggregate to fund the individual plaintiff settlements, attorneys' fees and administrative costs of the settlement, subject to certain excluded costs which defendants will be separately responsible for. The settlement amounts for each individual plaintiff will be determined by a third party. If any plaintiff decides not to accept the settlement, then the amount allocated to that plaintiff will be returned to defendants. Defendants have the right not to proceed with the settlement if a specified number of plaintiffs do not accept the settlement. Defendants' liability pursuant to the settlement is estimated to be \$15.5 million to \$17.5 million; however, defendants do not have a reasonable basis to estimate where in that range the liability is likely to be. Accordingly, for the quarter ended March 31, 2014, the Company is maintaining a reserve of \$15.5 million based on its assessment that the settlement is probable.

Approximately 97 of the remaining plaintiffs are not within the purview of the settlement arrangement described in the preceding paragraph. Any liability to these plaintiffs is expected to be an immaterial amount.

***False Claims Act***

*United States of America, ex rel. Melissa Simms Powell, et al. v. American InterContinental University, Inc., a Georgia Corporation, Career Education Corp., a Delaware Corporation and John Doe Nos. 1-100.* On July 28, 2009, we were served with a complaint filed in the U.S. District Court for the Northern District of Georgia, Atlanta Division. The complaint was originally filed under seal on July 14, 2008 by four former employees of the Dunwoody campus of our American InterContinental University on behalf of themselves and the federal government. On July 27, 2009, the Court ordered the complaint unsealed and we were notified that the U.S. Department of Justice declined to intervene in the action. When the federal government declines to intervene in a False Claims Act action, as it has done in this case, the private plaintiffs (or relators) may elect to pursue the litigation on behalf of the federal government and, if they are successful, receive a portion of the federal government's recovery. The action alleges violations of the False Claims Act and promissory fraud, including allegedly providing false certifications to the federal government regarding compliance with certain provisions of the Higher Education Act and accreditation standards. Relators claim that defendants' conduct caused the government to pay federal funds to defendants and to make payments to third-party lenders, which the government would not have made if not for defendants' alleged violation of the law. Relators seek treble damages plus civil penalties and attorneys' fees. On July 12, 2012, the Court granted our motion to dismiss for a lack of jurisdiction, the claims related to incentive compensation and proof of graduation. Thus, the only claim that remains pending against defendants is based on relators' contention that defendants misled the school's accreditor, Southern Association of Colleges and Schools, during the accreditation process. On December 16, 2013, we filed a motion for summary judgment on a variety of substantive grounds.





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Because of the many questions of fact and law that may arise, the outcome of this legal proceeding is uncertain at this point. Based on information available to us at present, we cannot reasonably estimate a range of potential loss, if any, for this action because the complaint does not seek a specified amount of damages and it is unclear how damages would be calculated, if we were to be found liable. Moreover, the case presents novel legal issues. Accordingly, we have not recognized any liability associated with this action.

*United States of America, ex rel. Brent M. Nelson v. Career Education Corporation, Sanford-Brown, Ltd., and Ultrasound Technical Services, Inc.* On April 18, 2013, defendants were served with an amended complaint filed in the U.S. District Court for the Eastern District of Wisconsin. The original complaint was filed under seal on July 30, 2012 by a former employee of Sanford-Brown College Milwaukee on behalf of himself and the federal government. On February 27, 2013, the Court ordered the complaint unsealed and we were notified that the U.S. Department of Justice declined to intervene in the action. After the federal government declined to intervene in this case, the relator elected to pursue the litigation on behalf of the federal government. If he is successful he will receive a portion of the federal government's recovery. The amended complaint was filed by the relator on April 12, 2013 and alleges violations of the False Claims Act, including allegedly providing false certifications to the federal government regarding compliance with certain provisions of the Higher Education Act and accreditation standards. Relator claims that defendants' conduct caused the government to pay federal funds to defendants, and to make payments to third-party lenders, which the government would not have made if not for defendants' alleged violation of the law. Relator seeks treble damages plus civil penalties and attorneys' fees. On June 11, 2013, defendants filed a motion to dismiss the case on a variety of grounds. The Court ruled on that motion, dismissing CEC from the case and dismissing several of the relator's factual claims. On November 27, 2013, Sanford Brown, LTD., and Ultrasound Technical Services, Inc., the remaining Company defendants, filed a motion to dismiss the case for lack of subject matter jurisdiction due to prior public disclosures of the relator's alleged claims. On March 17, 2014, the Court granted this motion in part, limiting the timeframe and geographical scope of the relator's claims. The Court has yet to rule on the summary judgment motion filed on January 3, 2014 by the remaining Company defendants. On April 8, 2014, the Court postponed the April 14, 2014 trial date pending its ruling on the summary judgment motion.

Because of the many questions of fact and law that may arise, the outcome of this legal proceeding is uncertain at this point. Based on information available to us at present, we cannot reasonably estimate a range of potential loss, if any, for this action because the complaint does not seek a specified amount of damages and it is unclear how damages would be calculated, if we were to be found liable. Moreover, the case presents novel legal issues. Accordingly, we have not recognized any liability associated with this action.

***Employment Litigation***

*Wilson, et al. v. Career Education Corporation.* On August 11, 2011, Riley Wilson, a former admissions representative based in Minnesota, filed a complaint in the U.S. District Court for the Northern District of Illinois. The two-count complaint asserts claims of breach of contract and unjust enrichment arising from our decision to terminate our Admissions Representative Supplemental Compensation ( ARSC ) Plan. In addition to his individual claims, Wilson also seeks to represent a nationwide class of similarly situated admissions representatives who also were affected by termination of the plan. On October 6, 2011, we filed a motion to dismiss the complaint. On April 13, 2012, the Court granted our motion to dismiss in its entirety and dismissed plaintiff's complaint for failure to state a claim. The Court dismissed this action with prejudice on May 14, 2012. On June 11, 2012, plaintiff filed a Notice of Appeal with the U.S. Court of Appeals for the Seventh Circuit appealing the final judgment of the trial court. Briefing was completed on October 30, 2012, and oral argument was held on December 3, 2012. On August 30, 2013, the Seventh Circuit affirmed the district court's ruling on plaintiff's unjust enrichment claim but reversed and remanded for further proceedings on plaintiff's breach of contract claim. On September 13, 2013, we filed a petition for rehearing to seek review of the panel's decision on the breach of contract claim and for certification of question to the Illinois

Supreme Court, but the petition was denied.

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The case now is on remand to the district court for further proceedings on the sole question of whether CEC's termination of the ARSC Plan violated the implied covenant of good faith and fair dealing. CEC has answered the complaint, and the parties have exchanged initial disclosures. On February 19, 2014, the Court ordered the parties to commence fact discovery as to the issue of liability.

Because the matter is in its early stages and because of the many questions of fact and law that may arise, the outcome of this legal proceeding is uncertain at this point. Based on information available to us at present, we cannot reasonably estimate a range of potential loss, if any, for this action. Accordingly, we have not recognized any liability associated with this action.

*Nimely, et al. v. Randstad General Partners, Randstad USA, Randstad Inhouse Services L.P., and Career Education Corporation.* On December 30, 2012, April R. Nimely, a former hourly, non-exempt call center employee based in Illinois filed a putative class and collective action complaint in the U.S. District Court for the Northern District of Illinois against the Company and various entities of the staffing firm Randstad, which the Company used to supplement its own staff at some of its call centers. The complaint asserts claims under the Fair Labor Standards Act, the Illinois Minimum Wage Law, and the Illinois Wage Payment and Collection Act ( IWPCA ) arising from the alleged failure to pay wages for work performed before and after shifts and during breaks. The putative collective class was defined as [a]ll persons who worked for [d]efendants as telephone dedicated employees, however titled, who were compensated, in part or in full, on an hourly basis throughout the United States at any time between December 30, 2009 and the present who did not receive the full amount of overtime wages earned and owed to them.

On February 27, 2013, defendants filed their answers to the complaint and motion to dismiss the IWPCA count of the complaint. On June 14, 2013, plaintiff filed her motion for class certification. The parties subsequently reached an agreement to settle the matter for an immaterial amount. On November 29, 2013, the Court entered an order granting preliminary approval of the settlement. On March 25, 2014, the Court granted final approval of the settlement and dismissed the case.

## ***Other Litigation***

In addition to the legal proceedings and other matters described above, we are also subject to a variety of other claims, suits and investigations that arise from time to time out of the conduct of our business, including, but not limited to, claims involving students or graduates and routine employment matters. While we currently believe that such claims, individually or in aggregate, will not have a material adverse impact on our financial position, cash flows or results of operations, these other matters are subject to inherent uncertainties, and management's view of these matters may change in the future. Were an unfavorable final outcome to occur in any one or more of these matters, there exists the possibility of a material adverse impact on our business, reputation, financial position, cash flows, and the results of operations for the period in which the effect becomes probable and reasonably estimable.

## **State Investigations**

The Attorney General of Connecticut is serving as the point of contact for inquiries received from the attorneys general of the following 14 states: Arkansas, Arizona, Connecticut, Idaho, Iowa, Kentucky, Missouri, Nebraska, North Carolina, Oregon, Pennsylvania and Washington (January 24, 2014); Illinois (December 9, 2011); and Tennessee (February 7, 2014). In addition, the Company has received inquiries from the Attorneys General of Florida (November 5, 2010), Massachusetts (September 27, 2012) and Colorado (August 27, 2013). The inquiries are civil investigative demands or subpoenas which relate to the investigation by the attorneys general of whether the Company and its schools have complied with certain state consumer protection laws, and generally focus on the Company's practices relating to the recruitment of students, graduate placement statistics, graduate certification and licensing results and

student lending activities, among other matters. Depending on the state, the documents and information sought by the attorneys general in connection with their investigations cover time periods as early as 2006 to the present. The Company intends to cooperate with the states involved with a view towards resolving these inquiries as promptly as possible.

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We cannot predict the scope, duration or outcome of these attorney general investigations. At the conclusion of any of these matters, the Company or certain of its schools may be subject to claims of failure to comply with state laws or regulations and may be required to pay significant financial penalties and/or curtail or modify their operations. Other state attorneys general may also initiate inquiries into the Company or its schools. If any of the foregoing occurs, our business, reputation, financial position, cash flows and results of operations could be materially adversely affected. Based on information available to us at present, we cannot reasonably estimate a range of potential monetary or non-monetary impact these investigations might have on the Company because it is uncertain what remedies, if any, these regulators might ultimately seek in connection with these investigations.

## **SEC Inquiry and Other Information Requests**

During the second quarter of 2012, the Company was advised by the Chicago Regional Office of the Securities and Exchange Commission ( SEC ) that it is conducting an inquiry pertaining to our previously reported 2011 investigation and review of student placement rate determination practices and related matters. We are cooperating fully with the inquiry. We cannot determine the eventual duration, scope or outcome of this matter.

The Company and its institutions have responded to requests for information regarding its 2011 investigation and review of placement determination practices and related matters from the Higher Learning Commission of the North Central Association of Colleges and Schools, Middle States Commission on Higher Education, Commonwealth of Pennsylvania Department of Education Division of Higher and Career Education, the Arizona State Board for Private Postsecondary Education, the Minnesota Office of Higher Education and the Florida Commission for Independent Education. Additionally, we have responded to follow-up requests from regulators for information regarding the terms of our August 2013 settlement with the New York Attorney General, including from the Higher Learning Commission of the North Central Association of Colleges and Schools and the Middle States Commission on Higher Education. We cannot predict the outcome of these information requests and any legal proceeding, claim or other matter that may arise relating thereto.

## **Regulatory Matters**

### ***ED Inquiry and HCM1 Status***

In December 2011, ED advised the Company that it is conducting an inquiry concerning possible violations of ED misrepresentation regulations related to placement rates reported by certain of the Company's institutions to accrediting bodies, students and potential students. This inquiry stems from the Company's self-reporting to ED of its internal investigation into student placement determination practices at the Company's Health Education campuses and review of placement determination practices at all of the Company's other domestic campuses in 2011. The Company has been cooperating with ED in connection with this inquiry. If ED determines that the Company or any of its institutions violated ED misrepresentation regulations with regard to the publication of placement rates or other disclosures to students or prospective students, ED may revoke, limit, suspend or deny the institution's Title IV eligibility, or impose fines. Any such action would first likely require reasonable prior notice and an opportunity for an administrative hearing (as recently confirmed by the U.S. Court of Appeals for the District of Columbia), and would be subject to appeal.

In December 2011, ED also moved all of the Company's institutions from the advance method of payment of Title IV Program funds to cash monitoring status (referred to as Heightened Cash Monitoring 1, or HCM1, status). Although the Company's prior practices substantially conformed to the requirements of this more restrictive method of drawing down students' Title IV Program funds, if ED finds violations of the HEA or related regulations, ED may impose monetary or program level sanctions, or transfer the Company's schools to the reimbursement or Heightened Cash

Monitoring 2 ( HCM2 ) methods of payment of Title IV Program funds. While on HCM2 status, an institution must disburse its own funds to students, document the students eligibility for Title IV Program funds and comply with certain waiting period requirements before receiving such funds from ED, which results in a significant delay in receiving those funds. The process of re-establishing a regular schedule of cash receipts for the Title IV Program funds if ED places our schools on reimbursement or

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HCM2 payment status could take several months, and would require us to fund ongoing operations substantially out of existing cash balances. If our existing cash balances are insufficient to sustain us through this transition period, we would need to pursue other sources of liquidity, which may not be available or may be costly.

**OIG Audit**

Our schools and universities are also subject to periodic audits by various regulatory bodies, including the U.S. Department of Education's Office of Inspector General (OIG). The OIG audit services division commenced a compliance audit of CTU in June 2010, covering the period July 5, 2009 to May 16, 2010, to determine whether CTU had policies and procedures to ensure that CTU administered Title IV Program and other federal program funds in accordance with applicable federal law and regulation. On January 13, 2012, the OIG issued a draft report identifying three findings, including one regarding the documentation of attendance of students enrolled in online programs and one regarding the calculation of returns of Title IV Program funds arising from student withdrawals without official notice to the institution. CTU submitted a written response to the OIG, contesting these findings, on March 2, 2012. CTU disagreed with the OIG's proposed determination of what constitutes appropriate documentation or verification of online academic activity during the time period covered by the audit. CTU's response asserted that this finding was based on the retroactive application of standards adopted as part of the program integrity regulations that first went into effect on July 1, 2011. The OIG final report, along with CTU's response to the draft report, was forwarded to ED's Office of Federal Student Aid on September 21, 2012. On October 24, 2012, CTU provided a further response challenging the findings of the report directly to ED's Office of Federal Student Aid. As a result of ED's review of these materials, on January 31, 2013, CTU received a request from ED that it perform two file reviews to determine potential liability on two discrete issues associated with one of the above findings. The first file review relates to any potential aid awarded to students who engaged in virtual classroom attendance activities prior to the official start date of a course and for which no further attendance was registered during the official class term. The second file review relates to students that were awarded and paid Pell funds for enrollment in two concurrent courses, while only registering attendance in one of the two courses. The Company completed these file reviews and provided supporting documentation to ED on April 10, 2013. As of March 31, 2014, the Company has a \$0.8 million reserve recorded related to this matter.

**9. INCOME TAXES**

The components of pretax loss from continuing operations for the quarters ended March 31, 2014 and 2013 are as follows (dollars in thousands):

	<b>For the Quarter Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
U.S.	\$ (47,225)	\$ (27,638)
Foreign		(4,558)
<b>Total</b>	<b>\$ (47,225)</b>	<b>\$ (32,196)</b>

The determination of the annual effective tax is based upon a number of significant estimates and judgments, including the estimated annual pretax income in each tax jurisdiction in which we operate and the ongoing development of tax planning strategies during the year. In addition, our provision for income taxes can be impacted by changes in tax rates or laws, the finalization of tax audits and reviews, as well as other factors that cannot be predicted



with certainty. As such, there can be significant volatility in interim tax provisions.

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The following is a summary of our provision for (benefit from) income taxes and effective tax rate from continuing operations:

	<b>For the Quarter Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Pretax loss	\$ (47,225)	\$ (32,196)
Provision for (benefit from) income taxes	\$ 220	\$ (12,402)
Effective rate	0.5%	-38.5%

As of December 31, 2013, we reported a total deferred tax valuation allowance of \$82.5 million within our consolidated balance sheet. After considering both positive and negative evidence related to the likelihood of realization of the deferred tax assets, we have determined that it is necessary to continue to record this valuation allowance against our net deferred tax assets as of March 31, 2014. As a result, the effective tax provision for the quarter ended March 31, 2014 approximates \$0.2 million.

The cumulative effect of federal and state valuation losses reduced the effective tax rate benefit by 38.7%. The current quarter tax rate was also impacted by nominal uncertain tax position activity, the net effect of which resulted in a 0.5% effective tax rate.

We estimate that it is reasonably possible that the liability for unrecognized tax benefits for a variety of uncertain tax positions will decrease by up to \$2.5 million in the next twelve months as a result of the completion of various tax audits currently in process and the expiration of the statute of limitations in several jurisdictions. The income tax rate for the quarter ended March 31, 2014 does not take into account the possible reduction of the liability for unrecognized tax benefits. The impact of a reduction to the liability will be treated as a discrete item in the period the reduction occurs. We recognize interest and penalties related to unrecognized tax benefits in tax expense. As of March 31, 2014, we had accrued \$2.8 million as an estimate for reasonably possible interest and accrued penalties.

Our tax returns are routinely examined by federal, state, local and foreign tax authorities and these audits are at various stages of completion at any given time. The Internal Revenue Service completed its examination of our U.S. income tax returns through our tax year ended December 31, 2007.

**10. SHARE-BASED COMPENSATION****Overview of Share-Based Compensation Plans**

The Career Education Corporation 2008 Incentive Compensation Plan (the 2008 Plan ) authorizes awards of stock options, stock appreciation rights, restricted stock, restricted stock units, deferred stock, performance units, annual incentive awards, and substitute awards, which generally may be settled in cash or shares of our common stock. Any shares of our common stock that are subject to awards of stock options or stock appreciation rights payable in shares will be counted as 1.0 share for each share issued for purposes of the aggregate share limit and any shares of our common stock that are subject to any other form of award payable in shares will be counted as 1.67 shares for each share issued for purposes of the aggregate share limit. As of March 31, 2014, there were approximately 5.7 million shares of common stock available for future share-based awards under the 2008 Plan, which is net of 4.4 million shares issuable upon exercise of outstanding options. This amount does not reflect 0.6 million shares underlying restricted stock units as of March 31, 2014, which upon vesting will be settled in shares of our common stock and thus reduce the common stock available for future share-based awards under the 2008 Plan by the amount vested,

multiplied by the applicable factor under the plan.

As of March 31, 2014, we estimate that compensation expense of approximately \$7.0 million will be recognized over the next four years for all unvested share-based awards that have been granted to participants, including stock options, shares of restricted stock and restricted stock units to be settled in shares of stock but excluding restricted stock units to be settled in cash.

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*Stock Options.* The exercise price of stock options granted under each of the plans is equal to the fair market value of our common stock on the date of grant. Employee stock options generally become exercisable 25% per year over a four-year service period beginning on the date of grant and expire ten years from the date of grant. Non-employee directors' stock options expire ten years from the date of grant and generally become exercisable as follows: one-fourth on the grant date and one-fourth for each of the first through third anniversaries of the grant date. Both employee stock options and non-employee director stock options are subject to possible earlier vesting and termination in certain circumstances. Generally, if a plan participant terminates his or her employment for any reason other than by death or disability during the vesting period, he or she forfeits the right to unvested stock option awards. Grants of stock options are generally only subject to the service conditions discussed previously.

Stock option activity during the quarter ended March 31, 2014 under all of our plans was as follows (options in thousands):

	<b>Options</b>	<b>Weighted Average Exercise Price</b>
Outstanding as of December 31, 2013	3,900	\$ 15.15
Granted	681	7.10
Exercised		
Forfeited	(147)	3.63
Cancelled	(46)	34.25
Outstanding as of March 31, 2014	4,388	\$ 14.09
Exercisable as of March 31, 2014	2,543	\$ 20.43

*Restricted Stock and Restricted Stock Units to be Settled in Stock.* Restricted stock and restricted stock units to be settled in shares of stock generally become fully vested either three years after the date of grant or 25% per year over a four-year service period beginning on the date of grant. Generally, if a plan participant terminates his or her employment for any reason other than by death or disability during the vesting period, he or she forfeits the right to the unvested restricted stock and restricted stock units. The vesting of restricted stock and restricted stock units is subject to possible acceleration in certain circumstances. Certain awards to plan participants referred to as performance-based are subject to performance conditions that, even if the requisite service period is met, may reduce the number of shares or units of restricted stock that vest at the end of the requisite service period or result in all shares or units being forfeited.

The following table summarizes information with respect to all outstanding restricted stock and restricted stock units to be settled in shares of stock under our plans during the quarter ended March 31, 2014 (shares and units in thousands):

<b>Restricted Stock to be Settled in Shares of Stock</b>				
Shares	Weighted Average Grant-Date Fair Value	Units	Weighted Average Grant-Date Fair	Total

	Per Share			Value Per Unit		
Outstanding as of December 31, 2013	221	\$ 22.19	539	\$ 8.30	760	
Granted			249	7.10	249	
Vested	(106)	23.27	(134)	8.63	(240)	
Forfeited	(24)	20.16	(44)	8.63	(68)	
Outstanding as of March 31, 2014	91	\$ 21.72	610	\$ 7.72	701	

*Restricted Stock Units to be Settled in Cash.* Restricted stock units to be settled in cash generally become fully vested 25% per year over a four-year service period beginning on the date of grant. Generally, if a plan participant terminates his or her employment for any reason other than by death or disability during the vesting period, he or she forfeits the right to the unvested restricted stock units. The vesting of restricted stock units is

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subject to possible acceleration in certain circumstances. Cash-settled restricted stock units are recorded as liabilities as the expense is recognized and the fair value for these awards is determined at each period end date with changes in fair value recorded in our statement of loss and comprehensive loss in the current period. Cash-settled restricted stock units are settled with a cash payment for each unit vested equal to the closing price on the vesting date. Cash-settled restricted stock units are not included in common shares reserved for issuance or available for issuance under the 2008 Plan.

The following table summarizes information with respect to all cash-settled restricted stock units during the quarter ended March 31, 2014 (units in thousands):

	<b>Restricted Stock Units to be Settled in Cash</b>
Outstanding as of December 31, 2013	2,289
Granted	966
Vested	(655)
Forfeited	(225)
Outstanding as of March 31, 2014	2,375

Upon vesting, based on the conditions set forth in the award agreements, these units will be settled in cash. We valued these units in accordance with the guidance set forth by FASB ASC Topic 718 *Compensation-Stock Compensation* and recognized \$2.3 million of expense for the first quarter of 2014 for all cash-settled restricted stock units.

*Performance Unit Awards.* Performance unit awards granted during 2013 and 2014 are long-term incentive, cash-based awards. Payment of these awards is based upon a calculation of Total Shareholder Return (TSR) of CEC as compared to TSR across a specified peer group of our competitors over a three-year performance period ending on December 31, 2015 and 2016, respectively. These awards are recorded as liabilities as the expense is recognized and fair value for these awards is revalued at each period end date with changes in fair value recorded in our statement of loss and comprehensive loss in the current period. A liability of \$1.8 million was recorded as of March 31, 2014, which represents the fair value of the liability incurred through March 31, 2014 for these awards; \$0.7 million of expense was recorded during the quarter ended March 31, 2014.

**11. WEIGHTED AVERAGE COMMON SHARES**

Basic net (loss) income per share is calculated by dividing net (loss) income by the weighted average number of common shares outstanding for the period. Diluted earnings per share is computed by dividing net (loss) income by the weighted average number of shares assuming dilution. Dilutive common shares outstanding is computed using the Treasury Stock Method and reflects the additional shares that would be outstanding if dilutive stock options were exercised and restricted stock and restricted stock units were settled for common shares during the period.

Due to the fact that we reported a loss from continuing operations for the quarters ended March 31, 2014 and 2013, potential common stock equivalents are excluded from the diluted common shares outstanding calculation. Per FASB ASC Topic 260 *Earnings Per Share*, an entity that reports discontinued operations shall use income or loss from

continuing operations as the benchmark for calculating diluted common shares outstanding, and as such, we have zero common stock equivalents since these shares would have an anti-dilutive effect on our net loss per share for the quarters ended March 31, 2014 and 2013.

## **12. SEGMENT REPORTING**

Our segments are determined in accordance with FASB ASC Topic 280 *Segment Reporting* and are based upon how the Company analyzes performance and makes decisions. Effective January 2014, we have changed our segment reporting to align with the manner in which we are now managing the business. Each segment

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represents a group of postsecondary education providers that offer a variety of degree and non-degree academic programs. These segments are organized by key market segments to enhance brand focus and operational alignment within each segment to more effectively execute our strategic plan. Our reporting segments are described below.

**University Schools:**

*Colorado Technical University (CTU)* collectively offers academic programs in the career-oriented disciplines of business studies, information systems and technologies, criminal justice, computer science and engineering, and health sciences in an online, classroom or laboratory setting.

*American InterContinental University (AIU)* collectively offers academic programs in the career-oriented disciplines of business studies, information technologies, criminal justice and design technologies in an online, classroom or laboratory setting.

**Career Schools:**

*Career Colleges* includes Briarcliffe College, Brooks Institute, Harrington College of Design, Missouri College and our Sanford-Brown institutions. As of March 31, 2014, we announced the rebranding efforts related to our IADT and Brown College institutions; these institutions are now united under the Sanford-Brown name. The Career Colleges group collectively offer academic programs primarily in the career-oriented disciplines of health education that are complemented by certain programs in business studies and information technology, as well as visual communications, fashion design, photography, interior design, graphic design and video production, in a classroom, laboratory or online setting. In addition, continuing education and short-term vocational programs in the area of energy conservation are offered.

*Culinary Arts* includes our Le Cordon Bleu institutions in North America which collectively offer hands-on educational programs in the career-oriented disciplines of culinary arts and patisserie and baking in the commercial-grade kitchens of Le Cordon Bleu. Le Cordon Bleu also provides online programs in culinary arts and hotel and restaurant management.

**Transitional Schools** includes our campuses that are currently being taught out.

We evaluate segment performance based on operating results. Adjustments to reconcile segment results to consolidated results are included under the caption Corporate and Other, which primarily includes unallocated corporate activity and eliminations.

Summary financial information by reporting segment is as follows (dollars in thousands):

	For the Quarter Ended March 31,			
	Revenue		Operating (Loss) Income	
	2014	2013	2014	2013
CTU	\$ 87,031	\$ 90,209	\$ 14,186	\$ 15,912
AIU	52,573	66,299	(3,583)	3,146
<b>Total University Schools</b>	<b>139,604</b>	<b>156,508</b>	<b>10,603</b>	<b>19,058</b>



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Career Colleges	53,040	59,786	(17,150)	(15,003)
Culinary Arts	42,246	45,938	(18,046)	(12,137)
Total Career Schools	95,286	105,724	(35,196)	(27,140)
Corporate and Other	100		(11,136)	(6,368)
Subtotal	234,990	262,232	(35,729)	(14,450)
Transitional Schools	8,115	22,218	(12,143)	(10,580)
Total	\$ 243,105	\$ 284,450	\$ (47,872)	\$ (25,030)

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	<b>Total Assets as of <sup>(1)</sup></b>	
	<b>March 31, 2014</b>	<b>December 31, 2013</b>
CTU	\$ 74,253	\$ 75,441
AIU	53,431	54,426
<b>Total University Schools</b>	<b>127,684</b>	<b>129,867</b>
Career Colleges	55,713	58,718
Culinary Arts	104,230	108,349
<b>Total Career Schools</b>	<b>159,943</b>	<b>167,067</b>
<b>Corporate and Other</b>	<b>440,458</b>	<b>491,674</b>
<b>Subtotal</b>	<b>728,085</b>	<b>788,608</b>
Transitional Schools	11,484	13,433
Discontinued Operations	1,929	3,004
<b>Total</b>	<b>\$ 741,498</b>	<b>\$ 805,045</b>

- (1) Total assets do not include intercompany receivable or payable activity between schools and corporate and investments in subsidiaries.

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The discussion below contains forward-looking statements, as defined in Section 21E of the Securities Exchange Act of 1934, as amended, that reflect our current expectations regarding our future growth, results of operations, cash flows, performance and business prospects, and opportunities, as well as assumptions made by, and information currently available to, our management. We have tried to identify forward-looking statements by using words such as anticipate, believe, expect, estimate, on track to, will, continue to and similar expressions, but these words are not the exclusive means of identifying forward-looking statements. These statements are based on information currently available to us and are subject to various risks, uncertainties, and other factors, including, but not limited to, those matters discussed in Part I, Item 1A Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2013 that could cause our actual growth, results of operations, cash flows, performance, business prospects and opportunities to differ materially from those expressed in, or implied by, these statements. Except as expressly required by the federal securities laws, we undertake no obligation to update such factors or to publicly announce the results of any of the forward-looking statements contained herein to reflect future events, developments, or changed circumstances, or for any other reason.*

**Overview**

The colleges, institutions and universities that are part of the Career Education Corporation (CEC) family offer high-quality education to a diverse student population in a variety of career-oriented disciplines through online, on-ground and hybrid learning program offerings. In addition to its online offerings, Career Education serves students from campuses throughout the United States offering programs that lead to doctoral, master's, bachelor's and associate degrees, as well as to diplomas and certificates.

Our institutions include both universities that provide degree programs through the master or doctoral level and colleges that provide programs through the associate and bachelor level. The University group includes American InterContinental University (AIU) and Colorado Technical University (CTU) predominantly serving students online with career-focused degree programs that meet the educational demands of today's busy adults. The Career Schools group offers career-centered education primarily through ground-based campuses and includes Briarcliffe College, Brooks Institute, Harrington College of Design, Le Cordon Bleu North America (LCB), Missouri College and Sanford-Brown Institutes and Colleges (SBI and SBC, respectively). Through our colleges, institutions and universities, we are committed to providing high-quality education, enabling students to graduate and pursue rewarding career opportunities.

During the first quarter of 2014, the Company completed the teach-out of the following Sanford-Brown campuses: Austin, Collinsville, Cranston, Dearborn, Grand Rapids, Indianapolis, Portland, Tinley Park and Trevoze. As a result, all current and prior periods reflect these campuses as components of discontinued operations. In the fourth quarter of 2013, we completed the sale of our International Segment (see Note 2 Basis of Presentation of the notes to our unaudited consolidated financial statements) and accordingly, the prior period results of operations of our International Segment are reported within discontinued operations.

All prior period results have been recast to reflect our reporting segments on a comparable basis.

The following Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with our unaudited consolidated financial statements and the notes thereto appearing elsewhere in this Quarterly Report on Form 10-Q. The MD&A is intended to help investors understand the results of operations, financial condition and present business environment. The MD&A is organized as follows:

2014 First Quarter Overview

Consolidated Results of Operations

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Segment Results of Operations

Summary of Critical Accounting Policies and Estimates

Liquidity, Financial Position and Capital Resources

**2014 FIRST QUARTER OVERVIEW**

During the first quarter of 2014, we continued our focus on **Enrolling, Educating** and **Placing** our students into a better position to succeed professionally. Our goal is to make our organization a highly respected and financially sound educational institution and to accomplish this in a professional manner that always puts student interests at the forefront of every decision. Our ongoing efforts are aligned with student success.

Our first quarter results were in line with our expectations despite the continued economic and other challenges as well as severe weather impacts to some of our ground-based campuses during the current year quarter. The severe weather experienced across the nation resulted in ninety-six closures and delays for our campuses which created scheduling challenges for current students and impacted admissions advisor efforts with our prospective students. Despite the obstacles created by the extreme winter weather, we were able to generate another quarter of improvement in many of our key metrics, including increased student applications, positive trends in the rate at which we convert a prospective student inquiry to a student applicant as well as new and total student enrollments.

Excluding our campuses within the Transitional Schools segment, which no longer enroll new students, revenue declined approximately 10.4% as a result of the 8% decline in total student enrollment as compared to the prior year quarter. On a consolidated basis our revenue declined approximately 14.5% and total student enrollment declined 12% as compared to the prior year quarter. For the current year quarter, we reported an operating loss of \$47.9 million as compared to an operating loss of \$25.0 million in the prior year quarter primarily as a result of the decline in revenue. The current quarter results include \$6.8 million for proposed legal settlements as we continue to resolve outstanding legal matters.

Beginning in January of 2014, we terminated our previous student readiness program and replaced it with a new student orientation process which we believe provides a better and more engaged experience for students. This enhanced process has already been implemented within our University segments and is being instituted on a modified basis at most of our ground-based campuses. This change impacts how we calculate a new student enrollment. Accordingly, we have recast prior period new student enrollments within our University Schools segments to reflect this change in methodology.

We have identified four main objectives for our turnaround strategy during 2014, including:

generate modest University total student enrollment growth;

stabilize our Career Schools enrollments;

reduce our organizational cost structure; and

successfully complete the teach-out of our Transitional Schools, significantly lowering the financial losses associated with these campuses.

*Generate modest University total student enrollment growth*

As of March 31, 2014, total student enrollments showed sequential improvement in the rate of decline for each of the past five quarters due to both increased student applications and improved retention of our students. These improvements are a result of the changes we have made to our student intake models and shifts in marketing strategies across our institutions.

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Our University Schools group reported operating income of \$10.6 million for the current year quarter as compared to \$19.1 million in the prior year quarter which was primarily due to the 8% decrease in total student enrollments as compared to the prior year quarter. This enrollment decrease has continued to lessen over the past five quarters. We anticipate that this sequential improvement in the rate of decline for total student enrollments coupled with other positive metric indicators we are tracking will yield positive total student enrollment growth as compared to prior periods in the second half of 2014 within our University segments.

### Stabilize our Career Schools enrollments

During the first quarter of 2014, we united the educational mission of International Academy of Design and Technology (IADT), Brown College and Sanford-Brown to create comprehensive career schools under the Sanford-Brown name. Bringing these career-focused schools together expands the Sanford-Brown educational mission, allowing the schools to provide more comprehensive programs and resources to students at 18 campuses across the country. This group now makes up our Career Colleges reporting segment. As part of our strategy, we are also working to expand the mission and program offerings at the Sanford-Brown institutions to include courses in allied health, business, information technology and art and design, some of which offerings were not in their existing missions. Once approved by regulatory authorities, we anticipate that this program expansion will allow us to better serve students and communities by providing students with greater educational options. Also, campuses will have greater flexibility in their course offerings to better serve students and accommodate local workforce needs. Finally, we will benefit from efficiencies and a lower cost structure related to supporting one brand name. While we believe that we have adequately prepared students and faculty for this change, there may be temporary disruptions and volatility impacting our operating results for these institutions.

Another effort towards stabilizing our Career Schools enrollments includes changes and enhancements to our marketing strategies. We have shifted our strategy from a national approach to tailoring our marketing efforts to be more localized in each of our markets. We have engaged a marketing firm to assist us with this shift in strategy as well as to broaden the scope and appeal of the new Sanford- Brown brand. We expect these changes to benefit us in the long-term but may temporarily disrupt our lead flow volume as we make the changes. Within Culinary Arts, we have intensified our communication with local high schools and begun to change our creative and media strategies to better attract prospective students.

During the current year quarter, Career Schools' new student enrollments decreased 12% as compared to the prior year quarter. This decrease was primarily driven by an 18% decrease in Culinary Arts new student enrollments for the current year quarter as compared to the prior year. The re-introduction of the Associate program has resulted in a change in the mix of students to be more heavily weighted in the Associate program which has a longer program length. Students enrolling in the Associate program tend to have a lower show rate (the rate at which an applicant is converted to a new student enrollment) than students entering the shorter duration Certificate programs. As a result, new student enrollments on a comparative basis will be negatively impacted for the short term. As we move through the remainder of 2014, we expect total enrollments to increase over the prior year as the Associate program students enter their second year of the program.

### Reduce our organizational cost structure

Operating costs have decreased approximately \$18.5 million in the current year quarter as compared to the prior year quarter. Approximately \$12.5 million of the decrease was attributed to lower Transitional School expenses. The remaining \$6.0 million is a function of actions taken by management to lower costs, including right sizing and reengineering the Company, real estate consolidation and generating other organizational efficiencies. In addition, we benefited from lower metrically-driven costs as a result of lower total student enrollments. We continue to anticipate

realizing at least \$75 million of lower operating expenses in fiscal year 2014 as compared to 2013.



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### *Successfully complete the teach out of our Transitional Schools, significantly lowering the financial losses associated with these campuses*

During the first quarter of 2014, we completed the teach-out of nine campuses within our Transitional Schools segment. We remain on track to successfully complete the teach-out of 20 of our Transitional Schools in 2014, of which seven are expected to close during the second quarter of 2014. We estimate the 20 schools closing in 2014 will generate approximately \$36.0 million of operating losses. As of December 31, 2014, we expect to have ten campuses remaining within our Transitional Schools segment.

Revenue for our Transitional Schools decreased approximately \$14.1 million in the current year quarter as compared to the prior year quarter while our operating loss decreased approximately \$1.6 million for the same period. We continue to focus on managing our expenses as the schools finish their commitment to students. For the nine schools completing their teach-out during the current year quarter, we recorded approximately \$8.1 million for estimated remaining lease obligations related to their leased facilities. This charge was recorded within discontinued operations for the quarter ended March 31, 2014.

### *2014 Outlook*

As we look ahead to the remainder of 2014, we remain focused on the operational execution against our key goals we have set forth. We continue to evaluate our portfolio of assets to assess where best to deploy our capital and how to structure our organization to provide the greatest opportunity for long-term, sustainable shareholder growth, while upholding the interests of our students. There are a number of strategies that we can choose from to optimize our capital structure, including investing in new business technologies, long-term borrowing options, acquisitions or divestitures, modifying our equity structure or considering other organizational changes. Our strategy to return Career Education to profitability is through an understanding that our long-term success is rooted in the collective success of our students.

### *Regulatory updates*

*Gainful Employment.* On March 25, 2014, the Secretary of Education published a proposed rule on gainful employment which aims to require all programs at proprietary institutions and non-degree programs at public and non-profit institutions to demonstrate that they adequately prepare students for gainful employment in a recognized occupation. According to the proposed rule, for a program to meet that requirement, it would need to pass one of two debt-to-earnings (D/E) ratio tests and also have an acceptable program-level cohort default rate (pCDR), with the former being calculated only for program completers and the latter being calculated for all students who enrolled in the program and were scheduled to go into loan repayment during the applicable period, whether these individuals completed the program or not.

Two formulas have been devised for calculating D/E ratios, and programs must pass at least one of these two tests in order to meet the gainful employment requirement. The first formula is based on debt-to-discretionary income, which has a threshold of 20%, and the second formula is based on debt-to-annual earnings, which has a threshold of 8%. Programs with a debt-to-discretionary income ratio of greater than 20% but less than or equal to 30% or with a debt-to-annual earnings ratio of greater than 8% but less than or equal to 12%, would be considered to be in the zone.

Programs that fail to meet either the discretionary or annual earnings ratio for two out of any three consecutive award years, or that either fail to meet the requirement or are in the zone for four consecutive award years would be ineligible to participate in Title IV programs. Only student debt related to tuition, fees, books and supplies would be included in the calculation. During the first four years following implementation of the rule, programs that fail to meet

the earnings ratios based on student loan balances of the appropriate cohort may substitute the median loan balance of the most recent cohort of program graduates so that tuition adjustments made following the promulgation of the rule will be taken into account. If a final rule is enacted as

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proposed in March (and published on or before November 1, 2014), the first year of measurement will be debt from graduates in the 2010/2011 and 2011/2012 academic years with income being captured from the 2014 calendar year. For programs failing, alternate debt would be substituted from graduates during the 2014/2015 academic year using the same program level income from the 2014 calendar year.

The pCDR rate would be calculated for all students who enrolled in the program and who received one or more Title IV Stafford loans and entered into repayment on one or more of those loans during the federal fiscal year that is three years prior to the year in which the rate is calculated. If fewer than 30 borrowers entered repayment in a fiscal year, the cohort of borrowers would include in addition to those borrowers entering repayment in the fiscal year, those who entered repayment in the two preceding fiscal years. If a final rule is enacted as proposed in March (and is published on or before November 1, 2014), the first year of measurement of the pCDR rate would be for the 2013 cohort, which includes students who entered repayment between October 1, 2012 and September 30, 2013 and measures defaults as of September 30, 2015.

An institution would be required to notify all current and potential students within 30 days of receiving notification from the Department of Education that a program could become ineligible for the next award year. A program voluntarily withdrawn or deemed ineligible could not participate in Title IV programs for three years. All so-called gainful employment programs would need to disclose additional data to the public, including the total cost of tuition and fees for the full gainful employment program and the amount included in the cost of attendance, or assessed directly by the institution, for books, supplies and equipment. Programs that fall in the zone would be subject to additional disclosure obligations, including notifying students of the potential loss of Title IV eligibility.

We are evaluating the potential impact of the proposed gainful employment rule. Any final rule may adversely affect the eligibility of the programs we offer, primarily our culinary arts and design programs, and therefore our business could be materially and adversely impacted.

*Program Integrity.* The Department of Education is currently engaged in negotiated rulemaking on a set of six program integrity issues, including: clock to credit hour conversions, state authorization of distance learning, state authorization of foreign locations, cash management, retaking coursework and definition of adverse credit. Although negotiations are ongoing and we cannot predict what will be included in any final rule, the Department's proposed regulations regarding state authorization of distance learning could impose significant additional administrative burdens on state regulators as well as schools offering distance education. The newly proposed rules could require states that do not presently regulate delivery of online courses and programs to enact legislation or issue regulations that specifically address online educational programs, such as those offered by our schools, and/or alter regulations impacting the availability of exemptions from licensure, or otherwise affect our schools' operations. Our schools offering distance learning had already begun completing additional state applications for licensures or confirming exemptions for their distance learning programs prior to the partial invalidation of the October 2010 state authorization regulations, and we continued to process the applications that were submitted. Nonetheless, any forthcoming state authorization regulations could impose significant additional administrative burdens and costs upon our operations.

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The summary of selected financial data table below should be referenced in connection with a review of the following discussion of our results of operations for the quarters ended March 31, 2014 and 2013. Results for the prior year quarter have been recast to be comparable to the current quarter presentation (dollars in thousands):

	For the Quarter Ended March 31,				% Change 2014 vs. 2013
	2014	% of Total Revenue	2013	% of Total Revenue	
<b>TOTAL REVENUE</b>	\$ 243,105		\$ 284,450		-14.5%
<b>OPERATING EXPENSES</b>					
Educational services and facilities <sup>(1)</sup>	86,078	35.4%	102,757	36.1%	-16.2%
General and administrative <sup>(2)</sup>					
Advertising	70,748	29.1%	71,252	25.0%	-0.7%
Admissions	32,944	13.6%	36,496	12.8%	-9.7%
Administrative	80,222	33.0%	76,098	26.8%	5.4%
Bad debt	5,866	2.4%	5,751	2.0%	2.0%
<b>Total general and administrative expense</b>	<b>189,780</b>	<b>78.1%</b>	<b>189,597</b>	<b>66.7%</b>	