CAREER EDUCATION CORP
Form 10-Q
November 08, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2012

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	**36-3932190**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
231 N. Martingale Road	
Schaumburg, Illinois	**60173**
(Address of principal executive offices)	**(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 x 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 x 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 x	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 x

Number of shares of registrant s common stock, par value $0.01, outstanding as of October 31, 2012: 67,103,846

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CAREER EDUCATION CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share amounts)

	September 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 242,828	$ 280,592
Short-term investments	130,495	160,607
Total cash and cash equivalents and short-term investments	373,323	441,199
Student receivables, net of allowance for doubtful accounts of $35,180 and $43,891 as of September 30, 2012 and December 31, 2011, respectively	65,021	60,573
Student receivables held for sale	1,019	
Receivables, other, net	1,672	2,914
Prepaid expenses	75,183	62,399
Inventories	9,157	11,356
Deferred income tax assets, net	10,940	10,940
Other current assets	5,214	17,769
Assets of discontinued operations	3,441	3,328
Total current assets	544,970	610,478
NON-CURRENT ASSETS:		
Property and equipment, net	317,484	349,788
Goodwill	131,862	212,626
Intangible assets, net	74,032	77,186
Student receivables, net of allowance for doubtful accounts of $14,291 and $21,062 as of September 30, 2012 and December 31, 2011, respectively	8,016	9,297
Deferred income tax assets, net	9,452	9,522
Other assets, net	42,293	30,122
Assets of discontinued operations	16,920	17,101
TOTAL ASSETS	$ 1,145,029	$ 1,316,120
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Current maturities of capital lease obligations	$ 306	$ 844
Accounts payable	53,237	48,408
Accrued expenses:		
Payroll and related benefits	39,359	41,853
Advertising and production costs	20,993	17,717
Other	48,542	67,271
Deferred tuition revenue	135,483	144,947
Liabilities of discontinued operations	12,843	8,403
Total current liabilities	310,763	329,443
NON-CURRENT LIABILITIES:		
Capital lease obligations, net of current maturities		207
Deferred rent obligations	97,766	102,079
Other liabilities	35,894	40,365
Liabilities of discontinued operations	28,842	37,935

Total non-current liabilities	162,502	180,586
SHARE-BASED AWARDS SUBJECT TO REDEMPTION	99	110
STOCKHOLDERS EQUITY:		
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; 81,563,011 and 81,966,793 shares issued, 67,016,636 and 73,621,548 shares outstanding as of September 30, 2012 and December 31, 2011, respectively	816	820
Additional paid-in capital	599,534	590,965
Accumulated other comprehensive loss	(9,015)	(5,136)
Retained earnings	294,315	375,607
Cost of 14,546,375 and 8,345,245 shares in treasury as of September 30, 2012 and December 31, 2011, respectively	(213,985)	(156,275)
Total stockholders equity	671,665	805,981
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 1,145,029	$ 1,316,120

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

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CAREER EDUCATION CORPORATION AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(In thousands, except per share amounts)

	For the Quarters Ended September 30,		For the Years to Date Ended September 30,	
	2012	**2011**	**2012**	**2011**
REVENUE:				
Tuition and registration fees	$ 326,464	$ 417,420	$ 1,112,950	$ 1,396,557
Other	6,293	10,991	22,910	48,432
Total revenue	332,757	428,411	1,135,860	1,444,989
OPERATING EXPENSES:				
Educational services and facilities	133,206	152,727	431,739	476,370
General and administrative	227,369	233,647	667,618	695,313
Depreciation and amortization	20,429	22,156	60,555	62,563
Goodwill and asset impairment			85,661	2,676
Total operating expenses	381,004	408,530	1,245,573	1,236,922
Operating (loss) income	(48,247)	19,881	(109,713)	208,067
OTHER INCOME (EXPENSE):				
Interest income	686	263	1,426	749
Interest expense	(22)	(44)	(87)	(120)
Miscellaneous income	77	183		1,968
Total other income	741	402	1,339	2,597
PRETAX (LOSS) INCOME	(47,506)	20,283	(108,374)	210,664
(Benefit from) provision for income taxes	(16,675)	6,215	(30,109)	72,582
(LOSS) INCOME FROM CONTINUING OPERATIONS	(30,831)	14,068	(78,265)	138,082
(LOSS) INCOME FROM DISCONTINUED OPERATIONS, net of tax	(2,315)	(3,434)	(3,039)	940
NET (LOSS) INCOME	(33,146)	10,634	(81,304)	139,022
OTHER COMPREHENSIVE INCOME (LOSS), net of tax:				
Foreign currency translation adjustments	743	(11,761)	(3,553)	(269)
Unrealized (losses) gains on investments	(206)	(6)	(326)	40
Total other comprehensive income (loss)	537	(11,767)	(3,879)	(229)
COMPREHENSIVE (LOSS) INCOME	$ (32,609)	$ (1,133)	$ (85,183)	$ 138,793
NET (LOSS) INCOME PER SHARE BASIC:				
(Loss) income from continuing operations	$ (0.47)	$ 0.19	$ (1.18)	$ 1.84
(Loss) income from discontinued operations	(0.03)	(0.05)	(0.05)	0.02

Net (loss) income per share	$	(0.50)	$	0.14	$	(1.23)	$	1.86
NET (LOSS) INCOME PER SHARE DILUTED:								
(Loss) income from continuing operations	$	(0.47)	$	0.19	$	(1.18)	$	1.83
(Loss) income from discontinued operations		(0.03)		(0.05)		(0.05)		0.01
Net (loss) income per share	$	(0.50)	$	0.14	$	(1.23)	$	1.84
WEIGHTED AVERAGE SHARES OUTSTANDING:								
Basic		66,100		73,582		66,325		74,858
Diluted		66,100		74,058		66,325		75,518

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

CAREER EDUCATION CORPORATION AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	For the Years to Date Ended September 30,	
	2012	**2011**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$ (81,304)	$ 139,022
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Goodwill and asset impairment	85,661	2,676
Loss on pending sale of student receivables	930	
Depreciation and amortization expense	60,555	63,319
Bad debt expense	28,967	40,909
Compensation expense related to share-based awards	7,302	11,884
Loss (gain) on disposition of property and equipment	293	(1,794)
Changes in operating assets and liabilities	(69,910)	(46,599)
Net cash provided by operating activities	32,494	209,417
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale investments	(117,188)	(149,234)
Sales of available-for-sale investments	146,873	148,934
Purchases of property and equipment	(29,496)	(67,444)
Proceeds on the sale of assets		6,259
Business acquisition, net of acquired cash	(3,094)	
Other	(1,533)	40
Net cash used in investing activities	(4,438)	(61,445)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Purchase of treasury stock	(56,431)	(137,033)
Issuance of common stock	1,262	3,827
Tax benefit associated with stock option exercises		377
Payments of assumed loans upon business acquisition	(318)	
Payments of contingent consideration	(5,818)	(12,589)
Payments of capital lease obligations	(741)	(855)
Net cash used in financing activities	(62,046)	(146,273)
EFFECT OF FOREIGN CURRENCY EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS:	(3,774)	(2,080)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(37,764)	(381)
DISCONTINUED OPERATIONS CASH ACTIVITY INCLUDED ABOVE:		
Add: Cash balance of discontinued operations, beginning of the period		28,838
Less: Cash balance of discontinued operations, end of the period		36,428
CASH AND CASH EQUIVALENTS, beginning of the period	280,592	260,644
CASH AND CASH EQUIVALENTS, end of the period	$ 242,828	$ 252,673

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

CAREER EDUCATION CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF THE COMPANY

The colleges, schools and universities that are part of the Career Education Corporation (CEC) family offer high-quality education to a diverse student population of more than 80,000 students across the world in a variety of career-oriented disciplines through online, on-ground and hybrid learning program offerings. The more than 90 campuses that serve these students are located throughout the United States and in France, the United Kingdom and Monaco, and offer doctoral, master s, bachelor s and associate degrees and diploma and certificate programs.

We are an industry leader whose institutions are recognized globally. Those institutions include, among others, American InterContinental University (AIU); Brooks Institute; Colorado Technical University (CTU); Harrington College of Design; INSEEC Group (INSEEC) Schools; International University of Monaco (IUM); International Academy of Design & Technology (IADT); Le Cordon Bleu North America (LCB); and Sanford-Brown Institutes and Colleges. Through our schools, we are committed to providing high-quality education, enabling students to graduate and pursue rewarding career opportunities.

For more information, see our website at *www.careered.com*. The website includes a detailed listing of individual campus locations and web links to our colleges, schools and universities.

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 school 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 schools 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 and year to date ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012.

The unaudited consolidated financial statements presented herein include the accounts of CEC. All inter-company transactions and balances have been eliminated.

In November 2011, we completed the sale of our Istituto Marangoni schools in Milan, Paris and London. Accordingly, the results of operations for those schools 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 Istituto Marangoni as a component of discontinued operations. See Note 4 Discontinued Operations of these notes to our unaudited consolidated financial statements.

During the third quarter of 2012, we reclassified payments made for contingent consideration in association with our acquisition of the rights to the Le Cordon Bleu trade name on our unaudited consolidated statements of cash flows. As a result of this presentation error, the contingent consideration was reclassified from net cash used in investing activities to net cash used in financing activities. Our unaudited consolidated statement of cash flows for the year to date ended September 30, 2011 has been recast to be comparable to the current period.

3. RECENT ACCOUNTING PRONOUNCEMENTS

In July 2012, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2012-02, *Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment.* The amendments in this ASU give entities the option to first assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that an indefinite-lived intangible asset is impaired. If impairment is indicated, the fair value of the indefinite lived intangible asset should be determined and the quantitative impairment test should be performed by comparing the fair value with the carrying amount in accordance with Subtopic 350-30; if impairment is not indicated, the entity is not required to take further action. ASU 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity s financial statements for the most recent annual or interim period have not yet been issued. We are currently evaluating this guidance, and do not believe the adoption will impact the presentation of our financial condition, results of operation and disclosures.

We have evaluated and adopted the guidance of the following ASU s issued by the FASB in 2011; adopting these ASUs did not materially impact our financial condition, results of operations, and disclosures:

ASU No. 2011-08, *Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment,* issued September 2011. The amendments in this ASU give entities the option to assess qualitative factors to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount, as a basis for determining the need to perform the two-step goodwill impairment test described in Topic 350.

ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*, issued June 2011. This ASU requires that the total of comprehensive income, the components of net income, and the components of other comprehensive income be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements, and that reclassification adjustments from other comprehensive income to net income be presented on the face of the financial statements. The amendments in ASU 2011-05 do not change the items reported in other comprehensive income, when an item of other comprehensive income must be reclassified to net income or how earnings per share is calculated and presented. In addition, ASU No. 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU No. 2011-05* was issued in December 2011. ASU 2011-12 defers only those changes in ASU 2011-05 that pertain to how, when and where reclassification adjustments are presented.

ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, issued May 2011. This ASU develops common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with GAAP and International Financial Reporting Standards. Many of the amendments change the wording used to describe the GAAP requirements for measuring fair value and disclosing information about fair value measurements but do not change the application of the requirements in Topic 820; some of the amendments clarify the application of existing fair value measurement requirements; and other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements.

4. DISCONTINUED OPERATIONS

As of September 30, 2012, the results of operations for schools that have ceased operations or were sold are presented within discontinued operations.

The combined summary of unaudited results of operations for our discontinued operations for the quarters and years to date ended September 30, 2012 and 2011 were as follows:

	For the Quarters Ended September 30,		For the Years to Date Ended September 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Revenue	$	$ 2,904	$ 5	$ 26,881
(Loss) income before income tax	$ (3,107)	$ (5,275)	$ (4,500)	$ 1,290
Income tax (benefit) provision [1]	(792)	(1,841)	(1,461)	350
(Loss) income from discontinued operations, net of tax	$ (2,315)	$ (3,434)	$ (3,039)	$ 940

[1] Amount represents the difference between the total consolidated income tax (benefit) provision, calculated by applying the estimated full-year consolidated effective tax rate to (losses) / earnings reported for the period, and the income tax (benefit) provision for continuing operations, calculated by applying the estimated full-year effective tax rate for continuing operations to pretax (loss) income from continuing operations for the period.

Assets and liabilities of discontinued operations on our consolidated balance sheets as of September 30, 2012 and December 31, 2011 include the following:

	September 30, 2012	December 31, 2011
	(Dollars in thousands)	
Assets:		
Current assets:		
Receivables, net	$ 217	$ 104
Deferred income tax assets	3,224	3,224
Total current assets	3,441	3,328
Non-current assets:		
Deferred income tax assets	15,421	15,421
Other assets, net	1,499	1,680
Total assets of discontinued operations	$ 20,361	$ 20,429
Liabilities:		
Current liabilities:		
Accounts payable	$ 10	$ 3
Accrued expenses	420	498
Remaining lease obligations	12,413	7,902
Total current liabilities	12,843	8,403
Non-current liabilities:		
Remaining lease obligations	28,842	37,935
Total liabilities of discontinued operations	$ 41,685	$ 46,338

A number of the campuses that ceased operations have remaining lease obligations that expire over time with the latest expiration in 2019. A liability is recorded representing the fair value of the remaining lease obligation at the time in which 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 consolidated balance sheets, for our discontinued operations for the quarters and years to date ended September 30, 2012 and 2011 were as follows:

	Balance, Beginning of Period	Charges Incurred [1]	Net Cash Payments	Other [2]	Balance, End of Period
			(Dollars in thousands)		
For the quarter ended September 30, 2012	$ 41,215	$ 2,543	$ (2,503)	$	$ 41,255
For the quarter ended September 30, 2011	$ 43,895	$ 491	$ (2,450)	$	$ 41,936
For the year to date ended September 30, 2012	$ 45,837	$ 3,256	$ (7,838)	$	$ 41,255
For the year to date ended September 30, 2011	$ 50,378	$ 1,310	$ (8,284)	$ (1,468)	$ 41,936

(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 balances for newly vacated spaces that are netted with the losses incurred in the period recorded.

5. BUSINESS ACQUISITIONS

Luxury Attitude

On May 2, 2012, we acquired the European-based corporate training firm Luxury Attitude for approximately $3.1 million in cash. Luxury Attitude specializes in service and customer relations training for premium and luxury companies.

The allocation of purchase price resulted in approximately $2.9 million of goodwill being recorded. This amount represents the premium paid over the fair value of the net assets acquired. We paid this premium as this strategic acquisition enables Luxury Attitude to pursue expansion of its client base through the international reach of INSEEC and IUM. There are also plans to incorporate the premium customer relations curriculum into the online education platforms in the IUM and INSEEC programs. Providing innovative digital delivery of education through online and mobile platforms is a core competency of CEC.

Luxury Attitude s operating results are immaterial to our consolidated results and are included in the unaudited consolidated financial statements from the date of acquisition.

Everblue Training Institute

On December 1, 2011, we acquired Everblue Training Institute for approximately $9.8 million. Everblue specializes in providing job training in energy conservation fields primarily for the building and construction industry and offers educational sessions in more than 70 U.S. cities and seven international locations. It provides U.S. Green Building Council education programs including Leadership in Energy and Environmental Design (LEED) training for contractors, owners, operators, architects, engineers and government workers, as well as Building Performance Institute (BPI) training.

The purchase agreement also included a contingent consideration provision which is calculated based upon future revenue growth and operating margins. The amount due is also dependent upon the period of time in which the previous owners of Everblue remain with the Company. As such, the contingent consideration is being accounted for as compensation; it was not part of the consideration paid for the business. As of September 30, 2012, $1.6 million has been recorded related to this contingent consideration provision, of which approximately $1.3 million was recognized during the first quarter of 2012 due to the previous owners termination of employment with the Company in February 2012. The amount of actual contingent consideration is in dispute with the previous owners and may be subject to further adjustment.

The following table summarizes the final fair values of assets acquired and liabilities assumed as of December 1, 2011:

	(Dollars in thousands)
Current assets:	
Receivables	$ 1,185
Other current assets	285
Non-current assets:	
Property and equipment	147
Goodwill	8,853
Total assets acquired	10,470
Deferred tuition revenue	681
Total liabilities assumed	681
Net assets acquired	$ 9,789

6. FINANCIAL INSTRUMENTS

Cash and Cash Equivalents and Investments

Cash and cash equivalents and investments from our continuing operations consist of the following as of September 30, 2012 and December 31, 2011:

	September 30, 2012 (Dollars in thousands)			
		Gross Unrealized		
	Cost	Gain	(Loss)	Fair Value
Cash and cash equivalents:				
Cash	$ 211,098	$	$	$ 211,098
Money market funds	31,730			31,730
Total cash and cash equivalents	242,828			242,828
Short-term investments (available-for-sale):				
U.S. Treasury bills	103,984		(11)	103,973
U.S. Government Agencies	26,523		(1)	26,522
Total short-term investments (available-for-sale)	130,507		(12)	130,495
Total cash and cash equivalents and short-term investments	$ 373,335	$	$ (12)	$ 373,323
Long-term investments (available-for-sale):				
Municipal bonds	$ 11,150	$	$ (535)	$ 10,615

	December 31, 2011 (Dollars in thousands)			
		Gross Unrealized		
	Cost	Gain	(Loss)	Fair Value
Cash and cash equivalents:				
Cash	$ 157,317	$	$	$ 157,317
Money market funds	122,827	448		123,275
Total cash and cash equivalents	280,144	448		280,592
Short-term investments (available-for-sale):				
U.S. Treasury bills	133,648	31	(5)	133,674
U.S. Government Agencies	26,962		(29)	26,933
Total short-term investments (available-for-sale)	160,610	31	(34)	160,607
Total cash and cash equivalents and short-term investments	$ 440,754	$ 479	$ (34)	$ 441,199
Long-term investments (available-for-sale):				
Municipal bonds	$ 11,150	$	$ (735)	$ 10,415

In the table above, unrealized holding losses as of September 30, 2012 relate to short-term investments that have been in a continuous unrealized loss position for less than one year. The table also includes unrealized holding losses that relate to our long-term investments in municipal bonds, which are auction rate securities (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 decline in the fair value of our municipal bonds through September 30, 2012 is attributable to the continued lack of activity in the ARS market, exposing these investments to liquidity risk.

Included in cash and cash equivalents above are amounts related to certain of our European campuses that are operated on a not-for-profit basis. The cash and cash equivalents related to these schools have restrictions which require that the funds be utilized for these particular not-for-profit schools. The amount of cash and cash equivalents of our not-for-profit schools with restrictions was $70.2 million and $74.5 million at September 30, 2012 and December 31, 2011, respectively. Restrictions on cash balances have not affected our ability to fund operations.

Money market funds: Mutual funds that invest in lower risk securities and generate low yields. Such funds maintain clear investment guidelines and seek to limit credit, market and liquidity risks.

U.S. Treasury bills: Debt obligations issued by the U.S. government that pay interest at maturity. U.S. Treasury bills are generally traded at discounts to par value and mature in one year or less.

U.S. Government Agencies: Debt obligations issued by a Government Sponsored Enterprise (GSE) which pay interest. GSEs are privately-held corporations with public purposes created by the U.S. Congress to reduce the cost of capital for certain borrowing sectors of the economy. Our debt obligations are issued by Federal Home Loan Banks and generally trade at discounts to par value. These obligations mature in one year or less and have the implicit backing of the U.S. Government although they are not direct obligations of the U.S. Government.

Municipal bonds: Debt obligations issued by states, cities, counties, and other governmental entities, which earn federally tax-exempt interest. ARS generally have stated terms to maturity of greater than one year. We classify investments in ARS as non-current on our 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 continue to accrue interest and are auctioned on a set interval until the auction succeeds, the issuer calls the securities, or they mature. As of September 30, 2012, we have determined these investments are at risk for impairment due to the nature of the liquidity of the market over the past year. Cumulative unrealized losses as of September 30, 2012 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 investments and it is unlikely we will be required to sell the investments before recovery of their amortized cost basis.

Fair Value Measurements

The fair value measure of accounting for financial instruments 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; 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 September 30, 2012, we held investments that are required to be measured at fair value on a recurring basis. These investments (available-for-sale) consist of U.S. Treasury bills and U.S. Government Agencies that are publicly traded and for which market prices are readily available.

As of September 30, 2012, our investments in municipal bonds are classified as available-for-sale and reflected at fair value. The auction events for these investments have been failing for over three years. The fair values of these securities are estimated utilizing a discounted cash flow analysis as of September 30, 2012. These analyses consider, among other items, the collateralization underlying the security investments, the credit worthiness of the counterparty, the timing of expected future cash flows, and the expectation of the next time the security is expected to have a successful auction. These securities were 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 issued by FASB ASC Topic 820 *Fair Value Measurements* at September 30, 2012 and December 31, 2011 were as follows:

	As of September 30, 2012 (Dollars in thousands)			
	Level 1	Level 2	Level 3	Total
Municipal bonds	$	$	$ 10,615	$ 10,615
U.S. Treasury bills	103,973			103,973
U.S. Government Agencies	26,522			26,522
Totals	$ 130,495	$	$ 10,615	$ 141,110

	As of December 31, 2011 (Dollars in thousands)			
	Level 1	Level 2	Level 3	Total
Municipal bonds	$	$	$ 10,415	$ 10,415
U.S. Treasury bills	133,674			133,674
U.S. Government Agencies	26,933			26,933
Totals	$ 160,607	$	$ 10,415	$ 171,022

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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 year to date ended September 30, 2012:

	(Dollars in thousands)
Balance at December 31, 2011	$ 10,415
Unrealized gain	200
Balance at September 30, 2012	$ 10,615

Credit Agreement

As of September 30, 2012, we had letters of credit totaling $6.2 million outstanding under our $185.0 million U.S. Credit Agreement. Borrowing availability under our U.S. Credit Agreement as of September 30, 2012, was $178.8 million. Our U.S. Credit Agreement expired on October 31, 2012. Discussions surrounding the level and terms of a replacement credit facility are ongoing. Effective October 31, 2012, we have provided cash that will be restricted in use to provide securitization for the letters of credit previously covered under our U.S. Credit Agreement.

7. STUDENT RECEIVABLES

Student receivables represent funds owed to us in exchange for the educational services that have been 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 consolidated balance sheets as components of both current and non-current assets.

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 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.

We do not accrue interest on past due student receivables; interest is recorded only upon collection. Interest rates are determined at the time a payment plan is extended to a student.

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.

We regularly monitor compliance with the 90-10 Rule established under the The Higher Education Opportunity Act. As a result, during the third quarter of 2012, we delayed receipt of approximately $19.7 million of Title IV funds to help our institutions comply with the 90-10 Rule for fiscal 2012. Our student receivables balance increased during the current year quarter as compared to the prior year quarter as a result of this delay. These funds are expected to be drawn down during January 2013.

Student Receivables Under Extended Payment Plans and Recourse Loan Agreements

We had previously provided extended payment plans to certain students to help ensure that they could complete their educational programs. We have discontinued providing extended payment plans to students. As of September 30, 2012 and December 31, 2011, the amount of non-current student receivables under student extended payment plans, net of allowance for doubtful accounts and net of deferred tuition revenue, was $5.0 million and $6.1 million, respectively.

Previously, we had recourse 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. Our recourse loan agreement with Stillwater was terminated on April 29, 2007. Our recourse loan agreement with Sallie Mae ended on March 31, 2008.

Outstanding net recourse loan receivable balances for continuing operations as of September 30, 2012 and December 31, 2011 were $3.0 million and $3.2 million, respectively. These receivables are reported under non-current assets as a component of student receivables, net within the consolidated balance sheets.

Student Receivables Valuation Allowance

Changes in our current and non-current receivables allowance for the quarters and years to date ended September 30, 2012 and 2011 were as follows:

	Balance, Beginning of Period	Charges to Expense [1]	Amounts Written-off	Balance, End of Period
	(Dollars in thousands)			
For the quarter ended September 30, 2012	$ 53,687	$ 11,190	$ (15,406)	$ 49,471
For the quarter ended September 30, 2011	$ 78,048	$ 14,078	$ (22,045)	$ 70,081
For the year to date ended September 30, 2012	$ 64,953	$ 29,000	$ (44,482)	$ 49,471
For the year to date ended September 30, 2011	$ 90,939	$ 40,926	$ (61,784)	$ 70,081

(1) Charges to expense include an offset for recoveries of amounts previously written off of $2.4 million and $2.1 million for the quarters ended September 30, 2012 and 2011, respectively, and $7.5 million and $8.0 million for the years to date ended September 30, 2012 and 2011, respectively.

Fair Value Measurements

The carrying amount reported in our 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.

As of September 30, 2012, a decision had been made to sell a portion of our student receivables balance with a carrying amount of $1.9 million as of September 30, 2012. In accordance with ASC Paragraph 310-10-35-49, once an asset is transferred into the held for sale classification, it must be recorded at the lower of cost or fair value. Fair value for these student receivables was calculated based on the amount of the sale price for the transaction which was concluded during October 2012. As the fair value was determined based on a quoted price, these would be categorized as Level 1 per ASC Topic 820. The fair value adjustment of $0.9 million was recorded within our unaudited statements of income and comprehensive income as a component of general and administrative expense in September 2012. These student receivables were sold on October 11, 2012.

8. GOODWILL AND OTHER INTANGIBLE ASSETS

Changes in the carrying amount of goodwill during the year to date ended September 30, 2012 are as follows by segment:

	CTU	AIU	Health Education	Culinary Arts	Art & Design	International	Total
				(Dollars in thousands)			
Goodwill balance as of December 31, 2011	$ 45,938	$ 41,418	$ 41,871	$	$ 41,479	$ 41,920	$ 212,626
Goodwill impairment			(41,871)		(41,479)		(83,350)
Effect of foreign currency exchange rate changes						(310)	(310)
Acquisition of Luxury Attitude						2,896	2,896
Goodwill balance as of September 30, 2012	$ 45,938	$ 41,418	$	$	$	$ 44,506	$ 131,862

During the second quarter of 2012, in conjunction with the quarterly review process, we concluded that certain indicators existed to suggest the Health Education and Art & Design reporting units were at risk of their respective carrying values exceeding fair values as of June 30, 2012. A significant amount of judgment is involved in determining if an indicator of impairment has occurred. These indicators included, but were not limited to, a decline in cash flows, a decline in actual revenue and earnings as compared to projected results and a marked decline in new student interest which negatively impacted our overall student population.

In calculating the fair value for both of these reporting units, we performed extensive valuation analyses, utilizing both income and market approaches, in our goodwill assessment process. The following describes the valuation methodologies used to derive the fair value of our reporting units:

> *Income Approach:* To determine the estimated fair value of each reporting unit, we discount the expected cash flows which are developed by management. We estimate our future cash flows after considering current economic conditions and trends, estimated future operating results, our views of growth rates and anticipated future economic and regulatory conditions. The discount rate used represents the estimated weighted average cost of capital, which reflects the overall level of inherent risk involved in our future expected cash flows and the rate of return an outside investor would expect to earn. To estimate cash flows beyond the final year of our models, we use a terminal value approach. We incorporate the present value of the resulting terminal value into our estimate of fair value.

> *Market-Based Approach:* To corroborate the results of the income approach described above, we estimate the fair value of our reporting units using several market-based approaches, including the guideline company method, which focuses on comparing our risk profile and growth prospects to select reasonably similar publicly traded companies.

The determination of estimated fair value of each reporting unit requires significant estimates and assumptions, and as such, these fair value measurements are categorized as Level 3 per ASC Topic 820. These estimates and assumptions primarily include, but are not limited to, the discount rate, terminal growth rates, operating cash flow projections and capital expenditure forecasts. Due to the inherent uncertainty involved in making those estimates, actual results could differ from those estimates. We evaluate the merits of each significant assumption used, both individually and in the aggregate, to determine the fair value of each reporting unit for reasonableness.

As a result of the interim impairment test during the second quarter of 2012, we recorded goodwill impairment charges of $41.9 million and $41.5 million within Health Education and Art & Design, respectively, during the second quarter of 2012. Of the total charge, $8.9 million will be deductible for income tax purposes. In addition, in conjunction with the second step of the goodwill impairment test, fair values are assigned to all assets and liabilities for each reporting unit, including all other intangible assets, as if the reporting unit had been acquired in a business combination. The fair values for our indefinite-lived trade names within the Health Education segment declined below their respective carrying values, and as a result, we recorded a $1.0 million charge for our Sanford-Brown and Missouri College trade names during the second quarter of 2012.

As part of our quarterly analysis of our remaining goodwill and other indefinite-lived intangible asset balances, we determined that no indicators existed that would indicate a more likely than not impairment of these assets during the third quarter of 2012.

9. COMMITMENTS AND CONTINGENCIES

An accrual for estimated legal fees and settlements of $11.3 million and $15.4 million at September 30, 2012 and December 31, 2011, respectively, is presented within other current liabilities on our consolidated balance sheets.

Litigation

We are, or were, a party to the following legal proceedings that are outside the scope of ordinary routine litigation incidental to our business. Due to the inherent uncertainties of litigation, we cannot 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 United States 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 schools job placement rates and its compliance with accreditation policies. 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 asks 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. On May 3, 2012, lead plaintiffs filed a consolidated amended complaint, asserting the same claims alleged in the initial complaint, and naming the Company and two former executive officers as defendants. Lead plaintiffs seek damages on behalf of all persons who purchased the Company s common stock between February 19, 2009 and November 21, 2011. On October 30, 2012, the Court ruled on defendants motion to dismiss. The motion was granted as to defendant Graham and denied as to the other defendants. The Court further ordered the parties to meet and confer regarding discovery. A status hearing is scheduled for November 19, 2012.

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 potential 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.

Shareholder Derivative Actions and Demands

Bangari v. Lesnik, et al. On December 7, 2011, a derivative action was filed in the Circuit Court of Cook County, Chancery Division on behalf of the Company naming the Company s current Board of Directors as individual defendants and the Company as a nominal defendant. Plaintiff alleges breach of fiduciary duty and abuse of control by the individual defendants in connection with the Company s alleged ongoing failure to have proper internal controls in place to appropriately determine its schools placement rates or to comply with relevant accreditation policies regarding placement practices and determinations. Plaintiff asks for unspecified amounts in damages, interest, and costs, as well as ancillary relief. On February 10, 2012, the defendants filed motions to dismiss or stay the complaint. On August 21, 2012, the Court denied defendants motions to dismiss, and granted defendants request for a stay. A status hearing is scheduled for January 31, 2013.

Cook v. McCullough, et al. On December 22, 2011, a derivative action was filed in the United States District Court for the Northern District of Illinois on behalf of the Company naming the Company s current Board of Directors as well as various current and former officers as individual defendants and the Company as a nominal defendant. Plaintiff alleges breach of fiduciary duty, abuse of control and gross mismanagement by all of the individual defendants based on allegations similar to those asserted in Bangari, described above, and on the defendants alleged failure to prevent the Company s disclosure of allegedly misleading statements relating to placement rates. Plaintiff also asserts a claim of unjust enrichment against certain individual defendants due to their receipt of incentive-based compensation based on allegedly inflated short-term financial performance. Plaintiff asks for unspecified amounts in damages, interest, and costs, as well as ancillary relief. On March 16, 2012, defendants filed motions to dismiss or stay the complaint. The Court granted the motions to stay pending resolution of the motions to dismiss. On August 13, 2012, the Court denied defendants motions to dismiss, ordered defendants to answer the complaint by October 22, 2012, and to file a reply brief in further support of their motion to stay by November 7, 2012. The Court further ordered the parties to engage in certain preliminary discovery. Defendants filed an answer to the complaint on October 22, 2012. A hearing is scheduled for November 14, 2012.

Alex v. McCullough, et al. On November 5, 2012, a derivative action was filed in the United States District Court for the Northern District of Illinois on behalf of the Company naming the Company s current Board of Directors as well as various current and former officers as individual defendants and the Company as a nominal defendant. Plaintiff alleges breach of fiduciary duty, waste of corporate assets and unjust enrichment by all of the individual defendants based on allegations similar to those asserted in Bangari and Cook, described above. In addition, in connection with the Company s reporting of placement rates, plaintiff also asserts violations of Sections 10(b) and 20(a) of the Exchange Act against certain individual defendants. Plaintiff asks for unspecified amounts in damages, interest, and costs, as well as ancillary relief.

The Company s Board of Directors has addressed forming a Special Litigation Committee (SLC) for the purpose of conducting a thorough and independent investigation into the allegations raised in the Bangari and Cook derivative actions described above and any subsequent related claims. The SLC would be delegated the authority to take any and all actions as the SLC deems appropriate and in the best interests of the Company regarding what, if any, actions the Company should undertake with respect to the findings of the SLC.

Because of the many questions of fact and law that may arise, the outcome of these actions and investigation 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 these matters because they are in their early stages and the complaints do not seek a specified amount of damages. Accordingly, we have not recognized any liability associated with these matters.

Student Litigation

Amador, et al. v. California Culinary Academy and Career Education Corporation; Adams, et al. v. California Culinary Academy and Career Education Corporation. On September 27, 2007, Allison Amador and 36 other current and former students of the California Culinary Academy (CCA) filed a complaint in the California Superior Court in San Francisco. Plaintiffs plead their original complaint as a putative class action and allege four causes of action: fraud; constructive fraud; violation of the California Unfair Competition Law; and violation of the California Consumer Legal Remedies Act. Plaintiffs contend that CCA made a variety of misrepresentations to 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.

On April 3, 2008, the same counsel representing plaintiffs in the Amador action filed the Adams action on behalf of Jennifer Adams and several other unnamed members of the Amador putative class. The Adams action also was styled as a class action and was based on the same allegations underlying the Amador action and attempted to plead the same four causes of action pled in the Amador action. The Adams action was deemed related to the Amador action and was being handled by the same judge.

The parties executed a formal settlement agreement as of November 1, 2010. On April 18, 2012, the Court issued an order granting final approval of the settlement and on April 19, 2012, the Court entered a final judgment on the settlement.

On June 3, 2011, the same attorneys representing the class in the *Amador* action filed a separate complaint in the San Francisco County Superior Court entitled *Abarca v. California Culinary Academy, Inc., et al*, on behalf of 115 individuals who are opt outs in the Amador action and/or non-class members, and therefore not subject to the Amador settlement. On June 15, 2011, the same attorneys filed another action in the San Francisco County Superior Court entitled *Andrade, et al. v. California Culinary Academy, Inc., et al.*, on behalf of another 31 individuals who are opt outs in the *Amador* action and/or non-class members, and therefore not subject to the Amador settlement. On August 12, 2011, plaintiffs counsel filed a third action on behalf of five individuals who opted out of or were not parties to the Amador settlement entitled *Aprieto, et al. v. California Culinary Academy*. None of these three suits are being prosecuted as a class action. They each allege the same claims as were previously alleged in the Amador action, plus claims for breach of contract and violations of the repealed California Education Code. The plaintiffs in these cases seek damages, including consequential damages, punitive damages and attorneys fees. We have not responded to these three complaints, which have been deemed related and transferred to the same judge who has been handling the Amador case, because they have been stayed pending a final determination as to which of the remaining individual plaintiffs have viable claims that are not barred by the final judgment on the settlement in the class action. Certain of the plaintiffs in these cases filed claims or received notice of the settlement and did not file claims, and therefore their individual claims will be barred. The parties are engaged in preliminary discovery and a further status conference is scheduled for January 22, 2013.

Based on the Company s records, it appears that there are approximately 126 plaintiffs whose claims are not barred by the settlement, 44 of which accepted offers to compromise pursuant to the California Code of Civil Procedure and were paid approximately $0.4 million in the aggregate in settlement of these claims. These amounts were recorded in the third quarter of 2012 and the majority of the payments were made by September 30, 2012. There are about 80 plaintiffs remaining.

Because of the many questions of fact and law that may arise as discovery and pre-trial proceedings progress, the outcome of the *Abarca*, *Andrade* and *Aprieto* legal proceedings with respect to the remaining plaintiffs 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 these actions because these matters are in their early stages and involve many unresolved issues of fact and law. Accordingly, we have not recognized any liability associated with these actions, except as described above.

Lilley, et al. v. Career Education Corporation, et al. On February 11, 2008, a class action complaint was filed in the Circuit Court of Madison County, Illinois, naming the Company and Sanford-Brown College, Inc. as defendants. Plaintiffs filed amended complaints on September 5, 2008 and September 24, 2010. The five plaintiffs named in the amended complaint are former students who attended a medical assistant program at Sanford-Brown College located in Collinsville, Illinois. The amended complaint asserts claims for alleged violations of the Illinois Private Business and Vocational Schools Act, for alleged unfair conduct and deceptive conduct under the Illinois Consumer Fraud and Deceptive Business Practices Act, as well as common law claims of fraudulent misrepresentation and fraudulent omission.

In the amended complaint filed on September 24, 2010, the plaintiffs allege that the school s enrollment agreements contained false and misleading information regarding placement statistics, job opportunities and salaries and that Admissions, Financial Aid and Career Services personnel used standardized materials that allegedly contained false and/or deceptive information. Plaintiffs also allege that the school misused a standardized admissions test to determine program placement when the test was not intended for that purpose; failed to provide allegedly statutorily required loan repayment information; and misrepresented the transferability of credits. Plaintiffs seek compensatory, treble and punitive damages, disgorgement and restitution of all tuition monies received from medical assistant students, attorneys fees, costs and injunctive relief.

Defendants filed a motion to dismiss the amended complaint on October 20, 2010. On October 27, 2010 the Court granted defendants motion with respect to plaintiffs fraudulent omission claims. The Court denied the motion with respect to the statutory claims under the Private Schools Act and the Illinois Consumer Fraud Act and the common law fraudulent misrepresentation claim.

By Order dated December 3, 2010, the Court certified a class consisting of all persons who attended Sanford-Brown College in Collinsville, Illinois and enrolled in the Medical Assisting Program during the period from July 1, 2003 through November 29, 2010. This class consists of approximately 2,300 members. On February 10, 2011, the Fifth District Court of Appeals granted defendants petition for leave to appeal the trial court s class certification order. By Order filed on October 25, 2012, the Appellate Court reversed the class certification order. The Appellate Court also ruled that the four named plaintiffs can proceed with their individual causes of action and, if successful, receive an award of actual damages, treble damages if fraud is proven, injunctive relief and reasonable attorneys fees and costs. Plaintiffs have until November 15, 2012 to file a Petition for Rehearing with the Appellate Court. Plaintiffs could also seek review of the Appellate Court s decision by filing a Petition for Leave to Appeal with the Illinois Supreme Court.

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 potential 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.

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 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 Surrett. 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. 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. Thus, 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 Educational 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 entitled *Banks, et al. v. California School of Culinary Arts*, Los Angeles County Superior Court (by 316 individuals); *Abrica v. California School of Culinary Arts*, Los Angeles County Superior Court (by 373 individuals); *Aguilar, et al. v. California School of Culinary Arts*, Los Angeles County Superior Court (by 88 individuals); *Alday v. California School of Culinary Arts,* Los Angeles Superior Court (by 73 individuals); *Ackerman, et al. v. California School of Culinary Arts*, Los Angeles County Superior Court (by 27 individuals); *Arechiga, et al.* v. *California School of Culinary Arts*, Los Angeles County Superior Court (by 60 individuals); *Anderson, et al., v. California School of Culinary Arts*, Los Angeles County Superior Court (by 58 individuals); and *Allen v. California School of Culinary Arts*, Los Angeles Superior Court (by 12 individuals). All eight cases are being prosecuted on behalf of over one thousand former students. The allegations are 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.

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. Defendants response to the consolidated complaint was filed on July 13, 2012. The Court has lifted the stay on actions that were consolidated and the parties are now engaged in discovery.

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 two later versions of the arbitration agreement at issue, and denied the motions with respect to the earliest version signed by certain of the plaintiffs. Approximately 54 individuals signed the later two versions of the arbitration agreement, and their claims are subject to arbitration.

Over the last few months, defendants sent out offers to compromise pursuant to the California Code of Civil Procedure to 1,069 individual plaintiffs, 334 of which were accepted. The total amount that has been or will be paid to eliminate these claims is approximately $2.1 million. This aggregate amount was recorded in the third quarter of 2012 and the majority of the payments were made by September 30, 2012. Due to the recent addition of new plaintiffs, there are currently approximately 900 active plaintiffs in the consolidated action.

Because of the many questions of fact and law that have already arisen and that may arise in the future, the outcome of these legal proceedings 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 these actions with respect to the current plaintiffs because our possible liability depends 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 these actions except as described above.

Kishia Houck, et al. v. Career Education Corporation and International Academy of Merchandising & Design, Inc., and *Juan Antonio Morales, et al. v. Career Education Corporation and International Academy of Merchandising & Design, Inc.* On May 23, 2012, a putative class action was filed in the Circuit Court of the Thirteenth Judicial Circuit for Hillsborough County, Florida, captioned *Kishia Houck, et al. v. Career Education Corporation and International Academy of Merchandising & Design, Inc.* The *Houck* plaintiffs allege causes of action under Florida s Deceptive and Unfair Trade Practices Act and for breach of the implied covenant of good faith and fair dealing, unjust enrichment, and breach of fiduciary duty. They allege that defendants made a variety of misrepresentations to them, relating generally to salary and employment prospects, instructor qualifications, transferability of credits, career placement services, the reputation of the International Academy of Merchandising & Design, Inc., the value and quality of the education, the overall cost to attend the school, and relevant student loan information. The putative class is defined as including all students who are or have enrolled in defendants degree programs at its Tampa and Orlando, Florida campuses during an undetermined time period. The *Houck* plaintiffs seek to recover damages and also seek declaratory and injunctive relief.

On July 5, 2012, the action was removed to the U.S. District Court for the Middle District of Florida. On August 3, 2012, the *Houck* plaintiffs filed a Third Amended Class Action Complaint. On September 7, 2012, defendants moved to dismiss the *Houck* plaintiffs claims and to compel arbitration. On October 12, 2012, the parties jointly moved the court to postpone most case activity until it decides whether to refer the case for arbitration.

On September 11, 2012, a second putative class action was filed in the United States District Court for the Middle District of Florida, captioned *Juan Antonio Morales, et al. v. Career Education Corporation and International Academy of Merchandising & Design, Inc.* The Morales plaintiffs allege essentially the same factual bases and causes of action as in *Houck*, but they have added a request for punitive damages. The definition of the putative class in *Morales* is the same as in *Houck*.

On October 23, 2012, the *Morales* plaintiffs filed a First Amended Complaint in which, among other things, they added several additional plaintiffs, including a proposed class representative, and a claim for civil conspiracy. Thus, *Morales* included causes of action under Florida s Deceptive and Unfair Trade Practices Act, and for breach of the implied covenant of good faith and fair dealing, unjust enrichment, breach of fiduciary duty, and civil conspiracy. On November 2, 2012, the court ordered *Morales* closed, incorporated it into *Houck*, and ordered that all further pleadings shall be filed in *Houck*.

Because of the many questions of fact and law that have already arisen and that may arise in the future, the outcome of these legal proceedings 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 these actions 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.

Danielle Brainard, et al. v. Career Education Corporation and Sanford-Brown Limited, Inc. On September 11, 2012, a putative class action was filed in the United States District Court for the Middle District of Florida, captioned *Danielle Brainard, et al. v. Career Education Corporation and Sanford-Brown Limited, Inc. d/b/a/ Sanford-Brown College and d/b/a/ Sanford-Brown Institute-Orlando.* In their complaint, plaintiffs alleged causes of action under Florida s Deceptive and Unfair Trade Practices Act and the Federal Racketeer Influenced and Corrupt Organizations Act (RICO), for breach of the implied covenant of good faith and fair dealing, unjust enrichment, and breach of fiduciary duty. Plaintiffs allege that defendants made a variety of misrepresentations to them, relating generally to salary and employment prospects, instructor qualifications, transferability of credits, the necessity for completing a medical assistant program before enrolling in other technical programs, career placement services, the reputation of Sanford-Brown College and Sanford-Brown Institute, the value and quality of the education, the overall cost to attend the school, and relevant student loan information. The putative classes are defined as including (1) all students who are or have enrolled in defendants degree programs at its Tampa and Orlando, Florida campuses during an undetermined time period, and (2) all students who are or have enrolled in defendants degree programs at any of their Sanford-Brown campuses throughout the United States during an undetermined period who were told by defendants that they had to complete a medical assistant program prior to enrolling in other technical programs. Plaintiffs seek to recover damages and also seek declaratory and injunctive relief.

On October 18, 2012, plaintiffs filed a First Amended Complaint. In this amended pleading, plaintiffs added several additional plaintiffs and a claim for civil conspiracy. The deadline for defendants to answer or otherwise respond to the First Amended Complaint is November 5, 2012.

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, among other things, our potential liability depends on whether a class or classes are certified and, if so, the composition and size of any such class(es) 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.

False Claims Act

False Claims Act Lawsuit. 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. The case is captioned *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 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, 31 U.S.C. § 3729(a)(1) and (2), 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. The lawsuit is currently in the discovery phase. 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.

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. Moreover, the case presents novel legal issues and discovery is in its early stages. Accordingly, we have not recognized any liability associated with this action.

Telephone Consumer Protection Act Litigation

Fahey, et al. v. Career Education Corporation; Rojas, et al. v. Career Education Corporation. On August 4, 2010, a putative class action lawsuit was filed in the Circuit Court of Cook County, Illinois, by Sheila Fahey alleging that she had received an unauthorized text message advertisement in violation of the Telephone Consumer Protection Act (the TCPA). On September 3, 2010, we removed this case to the U.S. District Court for the Northern District of Illinois.

On August 18, 2010, the same counsel representing plaintiffs in the Fahey action filed a similar lawsuit in the U.S. District Court for the Northern District of Illinois on behalf of Sergio Rojas alleging similar violations of the TCPA based on the same text messages. Rojas, like Fahey, sought class certification of his claims. The alleged classes are defined to include all persons who received unauthorized text message advertisements from the Company as part of the IADT test marketing campaign. Rojas and Fahey each sought an award trebling the statutory damages to the class members, together with costs and reasonable attorneys fees.

On March 14, 2012, we entered into a settlement agreement with plaintiffs counsel resolving the claims asserted in both cases. On October 23, 2012, the Court granted final approval of this settlement. Under the terms of the settlement agreement, we have agreed to pay $200 to each person who received the subject text message who can be identified and returns a valid claim form. Following an additional arbitration process, the Court awarded class counsel attorneys fees of $3.5 million as a total amount for both the Rojas and Fahey cases. Based upon the information available to us, we recorded a charge of $6.0 million in the fourth quarter of 2011 which represents our best estimate of the loss related to these matters.

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 United States 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 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 November 25, 2011, Wilson moved for class certification and appointment of class counsel, but briefing on that issue and all discovery were stayed pending a decision on the motion to dismiss. 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 United States Court of Appeals for the Seventh Circuit appealing the final judgment of the trial court. Briefing was completed on October 30, 2012. No hearing date for the appeal has been set.

Because plaintiff has filed a notice of appeal, 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.

Gonzalez, et al. v. Career Education Corporation, et al. On September 16, 2011, Karla Gonzalez and 19 other current and former employees of Southern California School of Culinary Arts, Ltd. (SCSCA) who worked primarily as Admissions Representatives filed a complaint in California Superior Court for the County of Los Angeles, Northeast District. The complaint names us, SCSCA, Le Cordon Bleu, Inc. and two former SCSCA employees as defendants. In their complaint, the plaintiffs allege, among other things, that the defendants (i) failed to pay them overtime and rest break compensation in violation of the California Labor Code; (ii) owe statutory penalties under the California Labor Code for unpaid wages; (iii) engaged in unfair competition and unfair business practices in violation of the California Business and Professions Code relating to false time records and failure to pay wages owed; (iv) breached contracts by failing to pay bonuses for enrolling students; (v) engaged in unfair competition and unfair business practices in violation of the California Business and

Professions Code by failing to report and intending to evade taxes; (vi) are responsible for statutory penalties under the California Private Attorneys General Act (PAGA) for violations of various sections of the California Code; and (vii) committed fraud by failing to pay allegedly promised bonuses and by altering time records. In their PAGA claim, plaintiffs seek recovery of penalties for violations of various wage and hour provisions of the California Code on behalf of themselves and all other similar current and former employees in California. In a first amended complaint filed in December 2011, plaintiffs dropped the individual defendants as defendants without prejudice. The remaining defendants responded to the first amended complaint on January 18, 2012, denying all material allegations. A second amended complaint was deemed filed on April 18, 2012.

On June 1, 2012, plaintiffs filed a third amended complaint in which they re-alleged counts (i) (vii) as identified above against the corporate defendants, and asserted count (vii) against the individual defendant. It also added new counts for violation of public policy relating to retaliation (new count viii) and intentional infliction of emotional distress (new count ix). The new counts were brought against all of the defendants. On August 15, 2012, the judge sustained demurrers regarding all but two of the new counts. The counts that survived were fraud against the individual defendant for alleged promises about bonus payments and violation of public policy relating to retaliation against the corporate defendants. The infliction of emotional distress claims were dismissed without leave to amend as to all defendants.

The defendants have answered the third amended complaint by denying all allegations, and the parties are engaged in discovery. Motions for summary judgment are due on November 29, 2012. Trial is scheduled to commence on February 25, 2013.

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 these matters are in their early stages, and involve many unresolved issues of fact and law. Accordingly, we have not recognized any liability associated with this action.

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 in the ordinary 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 Company received from the Attorney General of the State of New York (NYAG) a Subpoena Duces Tecum dated May 17, 2011 (the Subpoena), relating to the NYAG s investigation of whether the Company and certain of its schools have complied with certain New York state consumer protection, securities, finance and other laws. Pursuant to the Subpoena, the NYAG has requested from the Company, and certain of its schools, documents and detailed information on a broad spectrum of business practices, including such areas as marketing and advertising, student recruitment and admissions, education financing, training and compensation of admissions and financial aid personnel, programmatic accreditation, student employment outcomes, placement rates of graduates and other disclosures made to students. The documents and information sought by the NYAG in connection with its investigation cover the time period from May 17, 2005 to the present. As previously disclosed, at the direction of the Company s Board of Directors, an independent internal investigation was conducted into the determination of placement rates at the Company s Health Education segment schools as well as a review of such practices at all of its other domestic schools. The Company has reported the results of this investigation to the NYAG. The Company continues to cooperate with the NYAG with a view towards resolving this inquiry as promptly as possible.

The Florida campuses of Sanford-Brown Institute received a notice on November 5, 2010 from the State of Florida Office of the Attorney General that it has commenced an investigation into possible unfair and deceptive trade practices at these schools. The notice includes a subpoena to produce documents and detailed information for the time period from January 1, 2007 to the present about a broad spectrum of business practices at such schools. The Florida Attorney General s website indicates that the Attorney General is conducting similar investigations of several other postsecondary education companies operating schools located in Florida. The Florida campuses of Sanford-Brown Institute have responded to the subpoena and continue to cooperate with the Florida Attorney General with a view towards resolving this inquiry as promptly as possible.

The Company received from the Attorney General of the State of Illinois (IL AG) a Civil Investigative Demand (CID) dated December 9, 2011. The CID relates to the IL AG s investigation of whether the Company and its schools operating in Illinois have complied with certain Illinois state consumer protection laws. Pursuant to the CID, the IL AG has requested from the Company and its schools documents and detailed information on a broad spectrum of business practices, including such areas as marketing and advertising, student recruitment and admissions, education financing, training and compensation of admissions and financial aid personnel, programmatic accreditation, student employment outcomes, placement rates of graduates and other financial and organizational information. The documents and information sought by the IL AG in connection with its investigation cover the time period from January 1, 2006 to the present. The Company is cooperating with the IL AG s office with a view towards resolving this inquiry as promptly as possible.

The Company received from the Department of Justice of the State of Oregon (OR DOJ) an Investigative Demand (ID) dated January 3, 2012. The ID relates to the OR DOJ s investigation of whether the Company and AIU operating in Oregon have complied with certain Oregon state consumer protection laws. Pursuant to the ID, the OR DOJ has requested from the Company and AIU documents and detailed information on a broad spectrum of business practices, including such areas as consumer practices, accreditation, advertisements, recruitment, enrollment and admission of students, financial aid, records of discrimination complaints, academic performance, certain degree programs and student disclosures. The documents and information sought by the OR DOJ in connection with its investigation cover the time period from January 1, 2004 to the present. The Company is cooperating with the OR DOJ s office with a view towards resolving this inquiry as promptly as possible.

The Company received from the Commonwealth of Massachusetts Office of the Attorney General (MA AG) a Civil Investigative Demand dated September 27, 2012. The CID relates to the MA AG s investigation of whether certain of the Company s schools have complied with Massachusetts consumer protection laws in connection with marketing and advertising, job placement and student outcomes, the recruitment of students, and the financing of education. Pursuant to the CID, the MA AG has requested from the Company documents and detailed information covering a broad spectrum of areas, including student information, programs of study, externships, tuition, financial aid, default rates, graduation rates, employment outcomes, recruitment and admissions, career services, student disclosures, employee compensation, accreditation, advertising, and complaints relating to operations, recruitment, placement, retention, graduation and quality of education. The documents and information sought by the MA AG in connection with its investigation generally cover the time period from January 1, 2008 to the present, with some specific requests covering time periods as early as January 1, 2003 to the present. The Company is cooperating with the MA AG s office with a view towards resolving this inquiry as promptly as possible.

We cannot predict the scope, duration or outcome of these investigations. At the conclusion 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 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.

Accrediting Body and State and Federal Regulatory Matters

Placement Determination Practices Related Matters

As previously disclosed, last year the Company s Board of Directors directed independent legal counsel to conduct an investigation into student placement determination practices at its Health Education segment schools and to review placement determination practices at all of the Company s other domestic schools. The Company also previously disclosed that it informed the U.S. Department of Education (ED), state regulators and programmatic and institutional accrediting bodies of the investigation and review of placement determination practices, as appropriate. Following the completion of the investigation and review, the Company retained an independent third party to provide placement re-verification services to further review school placement data reported to accrediting bodies and other regulatory authorities. The Company has continued to refine its placement data review and re-verification processes since its reporting of 2011 annual placement rates to the Accrediting Council for Independent Colleges and Schools (ACICS) and the Accrediting Commission of Career Schools and Colleges (ACCSC).

On November 14, 2011, the Company received a letter from ACICS directing the Company, on behalf of certain of its ACICS-accredited institutions in the Health Education and Art & Design segments, to show-cause as to why accreditation should not be withdrawn from these ACICS-accredited institutions. The show-cause directive, which was later expanded to include all of the Company s ACICS-accredited institutions, related to the adequacy of the administrative practices and controls relative to the Company s determination of job placement rates. The Company provided ACICS with certain information in response to the show-cause directive, and on May 3, 2012, the Company received notification from ACICS that ACICS vacated the show-cause directive applicable to all 71 CEC institutions accredited by ACICS.

In connection with the show-cause proceeding, ACICS reviewed information it had requested of the Company regarding the annual placement rates for the period from July 1, 2010 through June 30, 2011 (the ACICS 2011 reporting year), which included the results of the independent third-party placement re-verifications described above. Based on ACICS interpretation of this information, 24 additional ACICS-accredited campuses fell below ACICS 65% placement rate standard for the ACICS 2011 reporting year and therefore are subject to increased levels of accreditation oversight, joining the 36 campuses already subject to this additional oversight based on the placement rates reported for the ACICS 2011 reporting year. This oversight includes, depending on the degree such campuses fell below the 65% placement rate standard, more detailed or frequent reporting requirements, the submission of a placement improvement plan, attendance by campus career service personnel at a placement workshop, additional requirements for new program and location approvals or on-site evaluations.

Four of these campuses, Sanford-Brown College Indianapolis, Sanford-Brown College Milwaukee, Sanford-Brown Institute Landover and the online campus of IADT, were placed on probation status due to placement rates at or below 40% for the ACICS 2011 reporting year. We have initiated a teach-out of the campuses in Milwaukee and Landover. These four campuses in the aggregate contributed approximately 3.6% of the Company s 2011 consolidated revenue. Campuses on probation remain accredited. An institution is obligated to demonstrate to ACICS that the conditions or circumstances which led to the imposition of probation have been corrected before probation will be lifted, in this case meaning an increase in placement rates to a level acceptable to ACICS.

On or before November 1, 2012, 71 campuses filed annual reports with ACICS including annual placement rates for the ACICS 2012 reporting year. Of those, 52 fell below ACICS 64% placement rate standard applicable for the ACICS 2012 reporting year, including 14 campuses that reported rates below 47% (the minimum ACICS compliance standard for the ACICS 2012 reporting year). These 14 campuses in the aggregate contributed approximately 7.7% of the Company s 2011 consolidated revenue. Three of the 14 campuses reporting rates below 47% are in the process of being taught out and five are newer start-up campuses which have been in operation for less than three years.

On June 7, 2012, ACCSC sent a letter notifying the Company that ACCSC had acted to direct the Company s ten ACCSC-accredited campuses (the ACCSC Institutions) to show cause as to why their accreditation should not be withdrawn. The show-cause directive stems from the Company s responses to ACCSC s previously disclosed information requests regarding the ACCSC Institutions student placement determination practices and reported employment rates to ACCSC, which included the results of the independent third-party placement re-verifications for graduates of such institutions included in the 2011 reporting period. Nine of the ten ACCSC Institutions are dually accredited by ACICS and therefore were included in the now-vacated ACICS show-cause directive. The tenth, Le Cordon Bleu Institute of Culinary Arts Pittsburgh, is scheduled to complete its teach-out of existing students on November 9, 2012.

The letter from ACCSC set forth the accreditor s requirements for the ACCSC Institutions to demonstrate compliance with its accrediting standards, which include the accelerated submission of employment placement rate data for the ACCSC 2012 reporting year for each program offered at the ACCSC Institutions, utilization of an independent third party to audit this employment placement rate data, additional analysis of previously submitted placement data and an update regarding the status of ACICS accreditation for the ACCSC Institutions and the ongoing ED inquiry described below. The Company provided the requested information to ACCSC on September 7, 2012 for review at its November 2012 meeting, and will continue working with ACCSC with a view towards resolving this matter as promptly as possible.

During the pendency of the ACCSC show-cause directive, the ACCSC Institutions remain accredited, but are subject to ACCSC restrictions regarding requests for any new programs or campuses.

On or around August 10, 2012, three of our Health Education campuses (Sanford-Brown Institute White Plains, Sanford-Brown Institute Landover, and Sanford-Brown College Tyson s Corner) were notified that the Accrediting Bureau of Health Education Schools (ABHES), who provides programmatic accreditation of their medical assisting programs, had acted at its July 2012 meeting to place them on show-cause as a result of site visit reports and questions related to their previously reported 2011 ABHES placement rates for their medical assisting programs (the same reporting year and placement data reviewed by ACICS and discussed above). On November 1, 2012, the three campuses provided a response which will be reviewed by ABHES at its next meeting in January 2013. Placement rates were recently reported to ABHES for the ABHES 2012 reporting year, and a majority of the applicable campuses reported rates below ABHES applicable placement rate standard.

In addition to the matters described above, the Company and its institutions have received other information requests regarding historical placement determination practices and related matters. As previously disclosed, the Company has responded to requests for information from ED, which has advised the Company that it is conducting an inquiry concerning possible violations by the Company of ED misrepresentation regulations in connection with historical placement rates provided to accrediting bodies, students and potential students. As also previously disclosed, ED recently 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 existing practices substantially conform to the requirements of this more restrictive method of drawing down students Title IV Program funds, if ED finds violations of the Higher Education Act of 1965, as amended (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, under which the 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 would result 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 HCM2 payment status could take several months, and would require us to fund ongoing operations substantially out of existing cash balances. In addition, if ED determines that an eligible institution has violated its 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.

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 internal investigation 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 also responded to requests for information regarding its investigation and review of placement determination practices from the Higher Learning Commission of the North Central Association of Colleges and Schools, Middle States Commission on Higher Education, Commonwealth of Pennsylvania Department 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.

We cannot predict with certainty the outcome of these accrediting body and state and federal regulatory matters, and any legal proceeding, claim or other matter that may arise relating to the matters discussed above. Because institutional accreditation by an accreditor recognized by ED is required for an institution to remain eligible to participate in the federal student financial aid programs, the failure by the Company to satisfactorily address the low placement rates of certain campuses and resolve these matters or any other matter that may arise could have a material adverse effect on our business, reputation, financial position, cash flows and results of operations.

Other Matters

Due to their participation in Title IV Programs, our schools and universities are subject to periodic program reviews by ED for the purpose of evaluating an institution s compliance with Title IV Program requirements, identifying any liabilities to ED caused by errors in compliance, and improving future institutional capabilities.

An ED program review report for Gibbs College Livingston, NJ (school closed) and a final determination letter for Katharine Gibbs School New York, NY (school closed) have been pending with ED since 2005. Given the passage of time, it is not clear that any final reports will be issued.

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, which will make an independent assessment of what further action, if any, is warranted.

We cannot predict the outcome of these matters, and any unfavorable outcomes could have a material adverse effect on our business, results of operations, cash flows and financial position.

In August 2011, the U.S. Department of Veterans Affairs (VA), through its Denver Regional Office (VA Regional Office), conducted a compliance survey at the Colorado Springs campus of CTU. The VA Regional Office also subsequently conducted compliance survey reviews at other CTU campuses, including Denver, Kansas City and Sioux Falls, as well as CTU Online. The VA Regional Office initially informed CTU that it had identified certain students for whom it believed CTU had incorrectly certified the monthly housing allowance provided pursuant to the Post-9/11 Veterans Educational Assistance Act (Post-9/11 GI Bill). While CTU believes the position of the VA Regional Office is based on a difference in interpretation of applicable provisions of law, CTU worked closely with the VA to ensure that students entitled to benefits under the Post-9/11 GI Bill were not adversely impacted or held responsible for any adjustments made respecting the monthly housing allowance. We previously estimated and accrued for a potential reimbursement on behalf of students by CTU of approximately $5.0 million. The VA concluded its review of all of the CTU campuses in September 2012 and assessed an aggregate potential student liability of approximately $3.6 million related to this compliance review, which CTU did not contest. CTU paid the VA on behalf of students in September 2012 and we believe this matter is now resolved.

10. INCOME TAXES

The components of pretax (loss) income from continuing operations for the quarters and years to date ended September 30, 2012 and 2011 are as follows:

	For the Quarters Ended September 30,		For the Years to Date Ended September 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
U.S.	$ (39,609)	$ 25,753	$ (109,274)	$ 205,454
Foreign	(7,897)	(5,470)	900	5,210
Total	$ (47,506)	$ 20,283	$ (108,374)	$ 210,664

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.

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

	For the Quarters Ended September 30,		For the Years to Date Ended September 30,	
	2012	2011	2012	2011
	(Dollars in thousands)			
Pretax (loss) income	$ (47,506)	$ 20,283	$ (108,374)	$ 210,664
Income tax (benefit) provision	$ (16,675)	$ 6,215	$ (30,109)	$ 72,582
Effective tax rate	35.1%	30.6%	27.8%	34.5%

The increase in the effective tax rate for the quarter ended September 30, 2012 as compared to the prior year quarter was primarily due to the inclusion of a $2.6 million favorable tax adjustment related to the expiration of the statute of limitations on a federal tax exposure, which was partially offset by an increase in the relative percentage of operating income that our foreign and not-for-profit institutions will contribute to our consolidated results of operations; both of which reduce the consolidated effective tax rate. Additionally, the rate is also impacted by various state income tax valuation allowances due to the change of forecasted earnings for some legal entities.

The decrease in the effective tax rate for the year to date ended September 30, 2012 as compared to the prior year was primarily due to the write-off of non-deductible goodwill and an increase in the relative percentage of operating income that our foreign and not-for-profit institutions will contribute to our consolidated results of operations. Additionally, the rate is also impacted by various state income tax valuation allowances due to the change of forecasted earnings for some legal entities. The current year to date effective tax rate also included $4.6 million in favorable tax adjustments related to the resolution of various state tax exposures and the expiration of the statute of limitations on other federal and state tax exposures which reduced our effective tax rate by 4.3%. The prior year to date effective tax rate included $1.6 million in favorable tax adjustments related to the correction of an error in previously filed U.S. income tax returns associated with the treatment of foreign interest income which reduced our effective tax rate by 0.7% for the year to date ended September 30, 2011.

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 $1.7 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 and year to date ended September 30, 2012 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 September 30, 2012, we had accrued $3.6 million as an estimate for reasonably possible interest and accrued penalties.

Our tax returns are routinely examined by federal, state 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.

11. STOCK REPURCHASE PROGRAM

During the quarter ended September 30, 2012, we did not repurchase any shares of our common stock. Year to date through September 30, 2012, we repurchased 6.1 million shares of our common stock for approximately $56.4 million at an average price of $9.29 per share. As of September 30, 2012, approximately $183.3 million was available under our authorized stock repurchase program to repurchase outstanding shares of our common stock. Stock repurchases under this program may be made on the open market or in privately negotiated transactions from time to time, depending on various factors, including market conditions and corporate and regulatory requirements. The stock repurchase program does not have an expiration date and may be suspended or discontinued at any time. The repurchase of shares of our common stock reduces the amount of cash available to pay cash dividends to our stockholders. We have never paid cash dividends on our common stock.

12. 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. 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 granted for purposes of the aggregate share limit and any shares of our common stock that are subject to any other form of award will be counted as 1.67 shares for each share granted for purposes of the aggregate share limit. As of September 30, 2012, there were approximately 10.0 million shares of common stock available for future share-based awards under the 2008 Plan. This amount does not reflect 4.0 million shares underlying restricted stock units and stock options outstanding as of September 30, 2012, which upon vesting or exercise 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.

As of September 30, 2012, we estimate that compensation expense of approximately $15.0 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. We expect to satisfy the exercise of stock options, any future distribution of shares of restricted stock and future distribution of shares upon settlement of restricted stock units by issuing new shares of common stock or by using treasury shares.

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-third on the grant date, one-third on the first anniversary of the grant date, and one-third on the second anniversary of the grant date, or, 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. In the first quarter of 2012, and for the first time since inception of any of our plans, we granted stock options containing a market condition to our Chief Executive Officer. We valued these stock options in accordance with the guidance set forth by FASB ASC Topic 718 *Compensation-Stock Compensation*.

Stock option activity during the year to date ended September 30, 2012 under all of our plans was as follows:

	Options (In thousands)	Weighted Average Exercise Price
Outstanding as of December 31, 2011	3,353	$ 27.79
Granted	526	8.00
Exercised		
Forfeited	(194)	18.70
Cancelled	(859)	23.94
Outstanding as of September 30, 2012	2,826	$ 25.90
Exercisable as of September 30, 2012	2,178	$ 29.62

Restricted Stock and Restricted Stock Units. Restricted stock and restricted stock units 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 restricted stock awarded to plan participants referred to as performance-based restricted stock 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.

In the year to date ended September 30, 2012, we awarded approximately 1.4 million restricted stock units under the 2008 Plan. Upon vesting, based on the conditions set forth in the award agreements, these units will be settled in shares of our common stock. We valued these units in accordance with the guidance set forth by FASB ASC Topic 718 *Compensation-Stock Compensation*.

The following table summarizes information with respect to all outstanding restricted stock and restricted stock units under our plans during the year to date ended September 30, 2012:

	Restricted Stock (Shares and Units in thousands)				
	Shares	**Weighted Average Grant-Date Fair Value Per Share**	**Units**	**Weighted Average Grant-Date Fair Value Per Unit**	**Total**
Outstanding as of December 31, 2011	1,797	$ 24.74		$	1,797
Granted			1,398	8.40	1,398
Vested	(372)	24.84			(372)
Forfeited	(516)	24.63	(215)	8.63	(731)
Outstanding as of September 30, 2012	909	$ 24.75	1,183	$ 8.35	2,092

13. WEIGHTED AVERAGE COMMON SHARES

The weighted average number of common shares used to compute basic and diluted net (loss) income per share for the quarters and years to date ended September 30, 2012 and 2011 were as follows:

	For the Quarters Ended September 30,		For the Years to Date Ended September 30,	
	2012	**2011**	**2012**	**2011**
	(Shares in thousands)			
Basic common shares outstanding	66,100	73,582	66,325	74,858
Common stock equivalents		476		660
Diluted common shares outstanding				