ITT EDUCATIONAL SERVICES INC
Form 10-Q/A
March 14, 2016
**Table of Contents**

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q/A**

**(Amendment No. 1)**

**(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, 2014**

**OR**

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

**For the transition period from __________ to __________**

**Commission file number 1-13144**

**ITT EDUCATIONAL SERVICES, INC.**

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

| | |
|---|---|
| **Delaware** | **36-2061311** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |
| **13000 North Meridian Street Carmel, Indiana** | **46032-1404** |
| **(Address of principal executive offices)** | **(Zip Code)** |

**Registrant s telephone number, including area code: (317) 706-9200**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No x

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. (Check one):

| | |
|---|---|
| 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

**23,552,683**

Number of shares of Common Stock, $.01 par value, outstanding at March 31, 2015

Table of Contents

# EXPLANATORY NOTE

## Restatement of Condensed Consolidated Financial Statements

ITT Educational Services, Inc. ( we, us or our ) is filing this Amendment No. 1 ( Amended Filing ) to its Quarterly Report on Form 10-Q for the quarter ended September 30, 2014, originally filed with the United States Securities and Exchange Commission ( SEC ) on April 29, 2015 (the Original Filing ), to amend and restate its unaudited condensed consolidated financial statements and related disclosures for the three and nine months ended September 30, 2014.

As a result of the execution of enhanced internal controls over financial reporting that were implemented as part of the remediation of material weaknesses identified in a prior period, we determined there was an error in the application of the interest method used to calculate the interest rate used in accounting for the accretion of the debt discount associated with a senior debt arrangement (the PEAKS Senior Debt ) that resulted in the misstatement of interest expense in previously reported interim periods.

Within this Amended Filing, we are restating our previously issued condensed consolidated financial statements as of and for the three and nine months ended September 30, 2014 to reflect this adjustment to the interest rate used in the application of the interest method to the discount on the PEAKS Senior Debt in that period.

The effects of the restatement on our unaudited condensed consolidated financial statements are a reduction in the amount of the debt discount, an increase in the carrying value of the PEAKS Senior Debt and an increase in interest expense. The restatement does not increase the total amount of non-cash interest expense that will be reported from the accretion of the debt discount on the PEAKS Senior Debt, but instead changes the timing of the recognition of that interest expense through the maturity date. The restatement also has no effect on our cash and cash equivalents or liquidity; cash flows from operating activities, financing activities or investing activities; or projections of our future cash payment obligations under our private education loan program guarantees.

In this Amended Filing, we are restating:

- our Condensed Consolidated Balance Sheet as of September 30, 2014 (unaudited);
- our Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2014 (unaudited);
- our Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2014 (unaudited);
- our Condensed Consolidated Statements of Cash Flows for the three and nine months ended September 30, 2014 (unaudited);
- our Condensed Consolidated Statements of Shareholders Equity for the nine months ended September 30, 2014 (unaudited); and

the Notes to those condensed consolidated financial statements.
See Note 2 Restatement of Previously Issued Financial Statements of the Notes to Condensed Consolidated Financial Statements for additional information.

In connection with the filing of our Annual Report on Form 10-K for the year ended December 31, 2014, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as a result of material weaknesses in our internal control over financial reporting.

Table of Contents

For ease of reference, this Amended Filing amends and restates the Original Filing in its entirety. The following Items have been revised to reflect the impact of the restatement on the affected line items of our condensed consolidated financial statements:

Part I, Item 1 Financial Statements

Part I, Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations

Part II, Item 6 Exhibits

We have also updated the signature page, the certifications of our Chief Executive Officer and Chief Financial Officer in Exhibits 31.1, 31.2, 32.1 and 32.2, and our unaudited consolidated financial statements formatted in eXtensible Business Reporting Language (XBRL) in Exhibit 101. In addition, we have revised certain other Items in this Amended Filing solely to change cross-references to the numbers of the notes to our condensed consolidated financial statements resulting from a renumbering of the notes to add a note regarding the restatement.

Except as provided in this Explanatory Note, or as indicated in the applicable disclosure, this Amended Filing has not been updated to reflect other events occurring after the filing of the Original Filing and does not modify or update information and disclosures in the Original Filing affected by subsequent events. Accordingly, this Amended Filing should be read in conjunction with our filings with the SEC subsequent to the date on which we filed the Original Filing, together with any amendments to those filings.

Table of Contents

**ITT EDUCATIONAL SERVICES, INC.**

Carmel, Indiana

Quarterly Report to Securities and Exchange Commission

September 30, 2014

## PART I

## FINANCIAL INFORMATION

### Item 1. Financial Statements.

**Index**

Table of Contents

**ITT EDUCATIONAL SERVICES, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(Dollars in thousands, except per share data)**

**(unaudited)**

| | As of | | |
|---|---|---|---|
| | **September 30, 2014 (as restated, see Note 2)** | **December 31, 2013** | **September 30, 2013** |
| **Assets** | | | |
| Current assets: | | | |
| Cash and cash equivalents | $ 204,227 | $ 215,771 | $ 165,581 |
| Restricted cash | 5,974 | 5,636 | 4,989 |
| Accounts receivable, net | 68,587 | 99,530 | 122,693 |
| Private education loans | 10,339 | 7,730 | 7,598 |
| Deferred income taxes | 51,053 | 77,549 | 77,343 |
| Prepaid expenses and other current assets | 48,478 | 28,400 | 21,671 |
| Total current assets | 388,658 | 434,616 | 399,875 |
| Property and equipment, net | 155,459 | 168,509 | 174,394 |
| Private education loans, excluding current portion, less allowance for loan losses of $42,931, $29,349 and $20,701 | 84,272 | 76,479 | 85,340 |
| Deferred income taxes | 73,292 | 68,324 | 40,949 |
| Other assets | 69,432 | 58,923 | 38,744 |
| Total assets | $ 771,113 | $ 806,851 | $ 739,302 |
| **Liabilities and Shareholders Equity** | | | |
| Current liabilities: | | | |
| Current portion of long-term debt | $ 50,000 | $ 50,000 | $ 0 |
| Current portion of PEAKS Trust senior debt | 96,516 | 157,883 | 134,075 |
| Current portion of 2009 Entity secured borrowing obligation | 20,662 | 0 | 0 |
| Accounts payable | 80,479 | 58,021 | 61,468 |
| Accrued compensation and benefits | 18,157 | 18,107 | 20,113 |
| Other current liabilities | 27,732 | 42,136 | 57,485 |
| Deferred revenue | 144,017 | 147,630 | 132,246 |
| Total current liabilities | 437,563 | 473,777 | 405,387 |
| Long-term debt | 0 | 0 | 60,000 |

| | | | |
|---|---|---|---|
| PEAKS Trust senior debt, excluding current portion | 53,320 | 71,341 | 94,420 |
| 2009 Entity secured borrowing obligation, excluding current portion | 101,880 | 0 | 0 |
| Other liabilities | 52,422 | 146,087 | 38,260 |
| Total liabilities | 645,185 | 691,205 | 598,067 |
| Shareholders equity: | | | |
| Preferred stock, $.01 par value, 5,000,000 shares authorized, none issued | 0 | 0 | 0 |
| Common stock, $.01 par value, 300,000,000 shares authorized, 37,068,904 issued | 371 | 371 | 371 |
| Capital surplus | 196,105 | 200,040 | 197,124 |
| Retained earnings | 949,146 | 940,449 | 979,830 |
| Accumulated other comprehensive income (loss) | 2,432 | 3,146 | (7,715) |
| Treasury stock, 13,619,729, 13,698,716 and 13,698,990 shares, at cost | (1,022,126) | (1,028,360) | (1,028,375) |
| Total shareholders equity | 125,928 | 115,646 | 141,235 |
| Total liabilities and shareholders equity | $ 771,113 | $ 806,851 | $ 739,302 |

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

2

Table of Contents

**ITT EDUCATIONAL SERVICES, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

**(Amounts in thousands, except per share data)**

**(unaudited)**

| | Three Months Ended September 30, 2014 (as restated, see Note 2) | Three Months Ended September 30, 2013 | Nine Months Ended September 30, 2014 (as restated, see Note 2) | Nine Months Ended September 30, 2013 |
|---|---|---|---|---|
| **Revenue** | $ 242,561 | $ 259,617 | $ 718,580 | $ 805,138 |
| **Costs and expenses:** | | | | |
| Cost of educational services | 117,539 | 120,204 | 353,930 | 367,921 |
| Student services and administrative expenses | 100,440 | 96,182 | 297,225 | 296,238 |
| Legal and professional fees related to certain lawsuits, investigations and accounting matters | 11,269 | 2,089 | 25,196 | 3,802 |
| Loss related to loan program guarantees | 2,019 | 4,826 | 2,019 | 8,629 |
| Provision for private education loan losses | 4,511 | 16,382 | 13,582 | 20,701 |
| Total costs and expenses | 235,778 | 239,683 | 691,952 | 697,291 |
| **Operating income** | 6,783 | 19,934 | 26,628 | 107,847 |
| Gain (loss) on consolidation of variable interest entities | 16,631 | 0 | 16,631 | (73,248) |
| Interest income | 17 | 16 | 51 | 75 |
| Interest (expense) | (9,292) | (7,190) | (28,315) | (18,133) |
| Income before provision for income taxes | 14,139 | 12,760 | 14,995 | 16,541 |
| Provision for income taxes | 6,017 | 3,336 | 6,266 | 4,184 |
| **Net income** | $ 8,122 | $ 9,424 | $ 8,729 | $ 12,357 |
| **Earnings per share:** | | | | |
| Basic | $ 0.35 | $ 0.40 | $ 0.37 | $ 0.53 |
| Diluted | $ 0.34 | $ 0.40 | $ 0.37 | $ 0.52 |
| **Weighted average shares outstanding:** | | | | |
| Basic | 23,483 | 23,418 | 23,463 | 23,410 |
| Diluted | 23,703 | 23,634 | 23,668 | 23,556 |

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

3

Table of Contents

**ITT EDUCATIONAL SERVICES, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(Dollars in thousands)**

**(unaudited)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2014 (as restated, see Note 2)** | **2013** | **2014 (as restated, see Note 2)** | **2013** |
| **Net income** | $ 8,122 | $ 9,424 | $ 8,729 | $ 12,357 |
| **Other comprehensive income (loss), net of tax:** | | | | |
| Net actuarial pension loss amortization, net of income tax of $0, $196, $0 and $589 | 0 | 310 | 0 | 929 |
| Prior service cost (credit) amortization, net of income tax of $151, $151, $452 and $453 | (238) | (238) | (714) | (714) |
| Other comprehensive income (loss), net of tax | (238) | 72 | (714) | 215 |
| **Comprehensive income** | $ 7,884 | $ 9,496 | $ 8,015 | $ 12,572 |

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

4

Table of Contents

**ITT EDUCATIONAL SERVICES, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Dollars in thousands)**

**(unaudited)**

| | Three Months Ended September 30, 2014 (as restated, see Note 2) | Three Months Ended September 30, 2013 | Nine Months Ended September 30, 2014 (as restated, see Note 2) | Nine Months Ended September 30, 2013 |
|---|---|---|---|---|
| **Cash flows from operating activities:** | | | | |
| Net income | $ 8,122 | $ 9,424 | $ 8,729 | $ 12,357 |
| Adjustments to reconcile net income to net cash flows from operating activities: | | | | |
| Depreciation and amortization | 5,537 | 6,173 | 18,507 | 20,816 |
| Provision for doubtful accounts | 16,830 | 14,526 | 47,212 | 44,755 |
| Deferred income taxes | 23,707 | (6,075) | 19,429 | (19,974) |
| Stock-based compensation expense | 2,667 | 3,304 | 7,529 | 8,698 |
| Settlement cost | 0 | 0 | 0 | (46,000) |
| Accretion of discount on private education loans | (2,727) | (4,072) | (9,099) | (9,536) |
| Accretion of discount on PEAKS Trust senior debt | 5,249 | 1,411 | 14,090 | 3,444 |
| Provision for private education loan losses | 4,511 | 16,382 | 13,582 | 20,701 |
| (Gain) loss on consolidation of variable interest entities | (16,631) | 0 | (16,631) | 73,248 |
| Other | (250) | 257 | (678) | 622 |
| Changes in operating assets and liabilities, net of acquisition: | | | | |
| Restricted cash | (468) | 830 | 2,400 | 192 |
| Accounts receivable | (16,480) | (10,275) | (15,498) | (87,503) |
| Private education loans | 4,221 | 3,434 | 12,314 | 8,013 |
| Accounts payable | 4,561 | (2,542) | 22,458 | (2,127) |
| Other operating assets and liabilities | (18,513) | 870 | (28,127) | (7,163) |
| Deferred revenue | 12,786 | 17,769 | (4,614) | (4,240) |
| Net cash flows from operating activities | 33,122 | 51,416 | 91,603 | 16,303 |
| **Cash flows from investing activities:** | | | | |
| Facility expenditures | (603) | (81) | (760) | (541) |
| Capital expenditures, net | (1,195) | (904) | (3,695) | (4,277) |
| Acquisition of company, net of cash acquired | (153) | (6,953) | (5,186) | (6,953) |
| Collateralization of letters of credit | (109) | 0 | (109) | 0 |
| Proceeds from repayment of notes | 100 | 91 | 293 | 413 |
| Note advances and purchases of investments | (1) | 0 | (2) | (1,241) |

| | | | | |
|---|---|---|---|---|
| Net cash flows from investing activities | (1,961) | (7,847) | (9,459) | (12,599) |
| **Cash flows from financing activities:** | | | | |
| Repayment of revolving borrowings | 0 | (60,000) | 0 | (80,000) |
| Repayment of PEAKS Trust senior debt | (51,706) | (537) | (92,776) | (1,198) |
| Common shares tendered for taxes | (184) | (19) | (912) | (390) |
| Net cash flows from financing activities | (51,890) | (60,556) | (93,688) | (81,588) |
| Net change in cash and cash equivalents | (20,729) | (16,987) | (11,544) | (77,884) |
| Cash and cash equivalents at beginning of period | 224,956 | 182,568 | 215,771 | 243,465 |
| **Cash and cash equivalents at end of period** | $ 204,227 | $ 165,581 | $ 204,227 | $ 165,581 |

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

Table of Contents

**ITT EDUCATIONAL SERVICES, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**

**(Dollars and shares in thousands)**

**(unaudited)**

| | Common Stock | | | | Accumulated Other | Common Stock in Treasury | | |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Capital Surplus | Retained Earnings | Comprehensive Income/(Loss) | Shares | Amount | Total |
| **Balance as of December 31, 2012** | 37,069 | $ 371 | $ 197,113 | $ 967,473 | $ (7,930) | (13,744) | $ (1,031,262) | $ 125,765 |
| For the nine months ended September 30, 2013: | | | | | | | | |
| Net income | | | | 12,357 | | | | 12,357 |
| Other comprehensive income, net of income tax | | | | | 215 | | | 215 |
| Equity award vesting | | | (3,277) | | | 68 | 3,277 | 0 |
| Tax benefit from equity awards | | | (5,410) | | | | | (5,410) |
| Stock-based compensation | | | 8,698 | | | | | 8,698 |
| Shares tendered for taxes | | | | | | (23) | (390) | (390) |
| **Balance as of September 30, 2013** | 37,069 | 371 | 197,124 | 979,830 | (7,715) | (13,699) | (1,028,375) | 141,235 |
| For the three months ended December 31, 2013: | | | | | | | | |
| Net (loss) | | | | (39,381) | | | | (39,381) |
| Other comprehensive income, net of income tax | | | | | 10,861 | | | 10,861 |
| Equity award vesting | | | (20) | | | 0 | 20 | 0 |
| Tax benefit from equity awards | | | (4) | | | | | (4) |
| Stock-based compensation | | | 2,940 | | | | | 2,940 |
| | | | | | | 0 | (5) | (5) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Shares tendered for taxes | | | | | | | | |
| **Balance as of December 31, 2013** | 37,069 | 371 | 200,040 | 940,449 | 3,146 | (13,699) | (1,028,360) | 115,646 |
| For the nine months ended September 30, 2014: | | | | | | | | |
| Net income (as restated, see Note 2) | | | | 8,729 | | | | 8,729 |
| Other comprehensive (loss), net of income tax | | | | | (714) | | | (714) |
| Equity award vesting | | | (7,076) | | | 120 | 7,076 | 0 |
| Tax benefit from equity awards | | | (4,388) | | | | | (4,388) |
| Stock-based compensation | | | 7,529 | | | | | 7,529 |
| Shares tendered for taxes | | | | | | (42) | (912) | (912) |
| Issuance of shares for Directors compensation | | | | (32) | | 1 | 70 | 38 |
| **Balance as of September 30, 2014 (as restated, see Note 2)** | 37,069 | $ 371 | $ 196,105 | $ 949,146 | $ 2,432 | (13,620) | $ (1,022,126) | $ 125,928 |

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

6

Table of Contents

**ITT EDUCATIONAL SERVICES, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(As Restated)**

**September 30, 2014**

**(Dollars in thousands, except per share data and unless otherwise stated)**

## 1. The Company and Basis of Presentation

We are a leading proprietary provider of postsecondary degree programs in the United States based on revenue and student enrollment. As of September 30, 2014, we were offering:

- master, bachelor and associate degree programs to approximately 57,000 students at ITT Technical Institute and Daniel Webster College locations; and

- short-term information technology and business learning solutions for career advancers and other professionals.

In addition, we offered one or more of our online degree programs to students who are located in all 50 states. As of September 30, 2014, we had 148 college locations (including 147 campuses and one learning site) in 39 states. In the fourth quarter of 2014, we closed three campuses and one learning site, resulting in 144 college locations as of December 31, 2014. All of our college locations are authorized by the applicable education authorities of the states in which they operate and are accredited by an accrediting commission recognized by the U.S. Department of Education ( ED ). We have provided career-oriented education programs since 1969 under the ITT Technical Institute name and since June 2009 under the Daniel Webster College name. In August 2013, we acquired all of the membership interests of Cable Holdings, LLC ( Cable Holdings ), an education company that offers short-term information technology and business learning solutions for career advancers and other professionals. In January 2014, we acquired certain assets and assumed certain liabilities of CompetenC Solutions, Inc. and Great Equalizer, Inc. CompetenC Solutions, Inc. and Great Equalizer, Inc. were education companies that operated primarily under the name of Ascolta ( Ascolta ) and offered short-term information technology and business learning solutions for career advancers and other professionals. See Note 5 Acquisition, for additional discussion of the acquisition of the Ascolta business. Our corporate headquarters are located in Carmel, Indiana.

The accompanying unaudited condensed consolidated financial statements include the accounts of ITT Educational Services, Inc., its wholly-owned subsidiaries and, beginning on February 28, 2013 and September 30, 2014, two variable interest entities ( VIEs ) that ITT Educational Services, Inc. consolidates in its consolidated financial statements, and have been prepared in accordance with generally accepted accounting principles in the United States ( GAAP ) for interim periods and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ( SEC ). Certain information and footnote disclosures, including significant accounting policies, normally included in a complete presentation of financial statements prepared in accordance with those principles, rules and regulations have been omitted. All significant intercompany balances and transactions are eliminated upon consolidation.

The Condensed Consolidated Balance Sheet as of December 31, 2013 was derived from audited financial statements but, as presented in this report, may not include all disclosures required by GAAP. Arrangements where we have a variable interest in another party are evaluated in accordance with the provisions of Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC or Codification ) 810, Consolidation ( ASC 810 ), to dete whether we are required to consolidate the other party in our consolidated financial statements. See Note 9 Variable Interest Entities, for a further discussion of the VIEs in which we held a variable interest and the consolidation of those two VIEs in our consolidated financial statements beginning on February 28, 2013 and September 30, 2014.

In the opinion of our management, the condensed consolidated financial statements reflect all adjustments that are normal, recurring and necessary for a fair presentation of our financial condition and results of operations. The interim financial information should be read in conjunction with the audited consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K as filed with the SEC for the fiscal year ended December 31, 2013, as amended ( 2013 Form 10-K ).

**2. Restatement of Previously Issued Financial Statements**

Subsequent to the Original Filing, we determined there was an error in the application of the interest method used to calculate the interest rate used in accounting for the accretion of the debt discount associated with our PEAKS Senior Debt. In our Original Filing, we accreted the debt discount associated with the PEAKS Senior Debt using the interest method based on the amounts and timing of the repayments that we estimated at the time that the PEAKS Senior Debt was initially included in our consolidated financial statements. We subsequently determined that the interest method should take into consideration actual repayments and updated projections for future repayments on the PEAKS Senior Debt to determine the interest rate used to calculate the amount of the debt discount recognized as interest expense in each period.

Table of Contents

As a result, we have restated the previously-issued unaudited condensed consolidated financial statements in our Quarterly Reports on Form 10-Q for each of the fiscal quarters ended March 31, 2014, June 30, 2014, September 30, 2014, March 31, 2015, June 30, 2015 and September 30, 2015, and our audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2014, and that those previously-issued financial statements should no longer be relied upon.

Our restated condensed consolidated financial statements as of and for the three and nine months ended September 30, 2014 included in this Amended Filing reflect the correction of this error. A reconciliation of previously reported amounts to the restated amounts is set forth in the tables below.

The following table sets forth the effect of the restatement on the affected line items on our Condensed Consolidated Balance Sheet as of September 30, 2014:

| | As of September 30, 2014 | | |
|---|---|---|---|
| | **As Previously Reported** | **Interest Method Adjustment** | **As Restated** |
| **Condensed Consolidated Balance Sheet Data:** | | | |
| Deferred income taxes | $ 69,685 | $ 3,607 | $ 73,292 |
| Total assets | 767,506 | 3,607 | 771,113 |
| Other current liabilities | 27,838 | (106) | 27,732 |
| Total current liabilities | 437,669 | (106) | 437,563 |
| PEAKS Trust senior debt, excluding current portion | 44,000 | 9,320 | 53,320 |
| Total liabilities | 635,971 | 9,214 | 645,185 |
| Retained earnings | 954,753 | (5,607) | 949,146 |
| Total shareholders equity | 131,535 | (5,607) | 125,928 |
| Total liabilities and shareholders equity | 767,506 | 3,607 | 771,113 |

Table of Contents

The following table sets forth the effect of the restatement on the affected line items on our Condensed Consolidated Statement of Income for the three months ended September 30, 2014:

| | Three Months Ended September 30, 2014 | | |
|---|---|---|---|
| | **As Previously Reported** | **Interest Method Adjustment** | **As Restated** |
| **Condensed Consolidated Statement of Income Data:** | | | |
| **Revenue** | $ 242,561 | $ 0 | $ 242,561 |
| **Costs and expenses:** | | | |
| Cost of educational services | 117,539 | 0 | 117,539 |
| Student services and administrative expenses | 100,440 | 0 | 100,440 |
| Legal and professional fees related to certain lawsuits, investigations and accounting matters | 11,269 | 0 | 11,269 |
| Loss related to loan program guarantees | 2,019 | 0 | 2,019 |
| Provision for private education loan losses | 4,511 | 0 | 4,511 |
| Total costs and expenses | 235,778 | 0 | 235,778 |
| **Operating income** | 6,783 | 0 | 6,783 |
| Gain on consolidation of variable interest entities | 16,631 | 0 | 16,631 |
| Interest income | 17 | 0 | 17 |
| Interest (expense) | (5,831) | (3,461) | (9,292) |
| **Income before provision for income taxes** | 17,600 | (3,461) | 14,139 |
| Provision for income taxes | 7,278 | (1,261) | 6,017 |
| **Net income** | $ 10,322 | $ (2,200) | $ 8,122 |
| **Earnings per share:** | | | |
| Basic | $ 0.44 | $ (0.09) | $ 0.35 |
| Diluted | $ 0.44 | $ (0.10) | $ 0.34 |
| **Weighted average shares outstanding:** | | | |
| Basic | 23,483 | 0 | 23,483 |
| Diluted | 23,703 | 0 | 23,703 |

Table of Contents

The following table sets forth the effect of the restatement on the affected line items on our Condensed Consolidated Statement of Income for the nine months ended September 30, 2014:

| | Nine Months Ended September 30, 2014 | | |
|---|---|---|---|
| | As Previously Reported | Interest Method Adjustment | As Restated |
| **Condensed Consolidated Statement of Income Data:** | | | |
| **Revenue** | $ 718,580 | $ 0 | $ 718,580 |
| **Costs and expenses:** | | | |
| Cost of educational services | 353,930 | 0 | 353,930 |
| Student services and administrative expenses | 297,225 | 0 | 297,225 |
| Legal and professional fees related to certain lawsuits, investigations and accounting matters | 25,196 | 0 | 25,196 |
| Loss related to loan program guarantees | 2,019 | 0 | 2,019 |
| Provision for private education loan losses | 13,582 | 0 | 13,582 |
| Total costs and expenses | 691,952 | 0 | 691,952 |
| **Operating income** | 26,628 | 0 | 26,628 |
| Gain on consolidation of variable interest entities | 16,631 | 0 | 16,631 |
| Interest income | 51 | 0 | 51 |
| Interest (expense) | (18,995) | (9,320) | (28,315) |
| **Income before provision for income taxes** | 24,315 | (9,320) | 14,995 |
| Provision for income taxes | 9,979 | (3,713) | 6,266 |
| **Net income** | $ 14,336 | $ (5,607) | $ 8,729 |
| **Earnings per share:** | | | |
| Basic | $ 0.61 | $ (0.24) | $ 0.37 |
| Diluted | $ 0.60 | $ (0.23) | $ 0.37 |
| **Weighted average shares outstanding:** | | | |
| Basic | 23,463 | 0 | 23,463 |
| Diluted | 23,777 | (109) | 23,668 |

The following table sets forth the effect of the restatement on the affected line items in our Condensed Consolidated Statement of Comprehensive Income for the three months ended September 30, 2014:

| | Three Months Ended September 30, 2014 | | |
|---|---|---|---|
| | As Previously Reported | Interest Method Adjustment | As Restated |

| | | | |
|---|---|---|---|
| **Condensed Consolidated Statement of Comprehensive Income Data:** | | | |
| Net income | $ 10,322 | $ (2,200) | $ 8,122 |
| Comprehensive income | 10,084 | (2,200) | 7,884 |

Table of Contents

The following table sets forth the effect of restatement on the affected line items in our Condensed Consolidated Statement of Comprehensive Income for the nine months ended September 30, 2014:

| | Nine Months Ended September 30, 2014 | | |
|---|---|---|---|
| | As Previously Reported | Interest Method Adjustment | As Restated |
| **Condensed Consolidated Statement of Comprehensive Income Data:** | | | |
| Net income | $ 14,336 | $ (5,607) | $ 8,729 |
| Comprehensive income | 13,622 | (5,607) | 8,015 |

The following table sets forth the effect of restatement on the affected line items in our Condensed Consolidated Statement of Cash Flows for the three months ended September 30, 2014:

| | Three Months Ended September 30, 2014 | | |
|---|---|---|---|
| | As Previously Reported | Interest Method Adjustment | As Restated |
| **Condensed Consolidated Statement of Cash Flows Data:** | | | |
| Net income | $ 10,322 | $ (2,200) | $ 8,122 |
| Deferred income taxes | 25,046 | (1,339) | 23,707 |
| Accretion of discount on PEAKS Trust senior debt | 1,788 | 3,461 | 5,249 |
| Other operating assets and liabilities | (18,591) | 78 | (18,513) |
| Net cash flows from operating activities | 33,122 | 0 | 33,122 |

The following table sets forth the effect of the restatement on the affected line items in our Condensed Consolidated Statement of Cash Flows for the nine months ended September 30, 2014:

| | Nine Months Ended September 30, 2014 | | |
|---|---|---|---|
| | As Previously Reported | Interest Method Adjustment | As Restated |
| **Condensed Consolidated Statement of Cash Flows Data:** | | | |
| Net income | $ 14,336 | $ (5,607) | $ 8,729 |
| Deferred income taxes | 23,036 | (3,607) | 19,429 |
| Accretion of discount on PEAKS Trust senior debt | 4,770 | 9,320 | 14,090 |
| Other operating assets and liabilities | (28,021) | (106) | (28,127) |
| Net cash flows from operating activities | 91,603 | 0 | 91,603 |

The following table sets forth the effect of the restatement on the affected line items in our Condensed Consolidated Statement of Shareholders Equity for the nine months ended September 30, 2014:

| | Nine Months Ended September 30, 2014 | | |
|---|---|---|---|
| | As Previously Reported | Interest Method Adjustment | As Restated |
| **Condensed Consolidated Statement of Shareholders Equity Data Retained Earnings:** | | | |
| Net income | $ 14,336 | $ (5,607) | $ 8,729 |
| Balance as of September 30, 2014 | 954,753 | (5,607) | 949,146 |

## 3. Accounting Policies

Subsequent to the disclosure of our significant accounting policies in our 2013 Form 10-K, we added the following significant accounting policy, which primarily relates to a VIE that we consolidated in our condensed consolidated financial statements in 2014. Beginning on September 30, 2014, we consolidated a VIE (the 2009 Entity ) that purchased, owns and collects private education loans (the 2009 Entity Student Loans ) made under a private education loan program for our students to help pay their cost of education that financial aid from federal, state and other sources did not cover (the 2009 Loan Program ) in our condensed consolidated financial statements (the 2009 Entity Consolidation ). See Note 9 Variable Interest Entities, for a further discussion of the 2009 Entity Consolidation.

***2009 Entity Secured Borrowing Obligation.*** The owners of the 2009 Entity (the 2009 Entity Participants ) purchased participation interests in the 2009 Entity Student Loans from the 2009 Entity. The terms of the agreements between the 2009 Entity Participants and the 2009 Entity did not meet the requirements under ASC 860, Transfers and Servicing ( ASC 860 ), to be considered a sale. As a result, the 2009 Entity was required to record a liability (the 2009 Entity Secured Borrowing Obligation ) on its balance sheet for the cash received from the 2009 Entity Participants. The 2009 Entity Secured Borrowing Obligation represents the estimated amount that the 2009 Entity owes to the 2009 Entity Participants related to their participation interests in the 2009 Entity Student Loans, which amount is expected to be paid to the 2009 Entity Participants by the 2009 Entity from payments received by the 2009 Entity related to the 2009 Entity Student Loans, whether from the borrower or from us under the risk sharing agreement (the 2009 RSA ) that we entered into with the 2009 Entity on February 20, 2009.

In accordance with ASC 810, we included the 2009 Entity Secured Borrowing Obligation on our condensed consolidated balance sheet at its fair value as of September 30, 2014, the date of the 2009 Entity Consolidation. The difference between the estimated fair value of the 2009 Entity Secured Borrowing Obligation and the amount expected to be paid by the 2009 Entity to the 2009 Entity Participants was recorded as an accrued discount on our condensed consolidated balance sheet at the date of the 2009 Entity Consolidation. The accrued discount is being recognized in interest expense at a level rate of return over the expected life of the 2009 Entity Secured Borrowing Obligation.

The expected life of the 2009 Entity Secured Borrowing Obligation is an estimate of the period of time over which payments are expected to be made by the 2009 Entity to the 2009 Entity Participants related to their participation interests in the 2009 Entity Student Loans. The period of time over which payments are expected to be made by the 2009 Entity to the 2009 Entity Participants is based on when the 2009 Entity Student Loans enter a repayment status and the period of time they remain in a repayment status. Since all of the 2009 Entity Student Loans have not entered repayment, and those loans that have entered repayment may be granted forbearances or deferments, the period of time over which payments are expected to be made to the 2009 Entity Participants is an estimate. The assumptions used to estimate the expected life of the 2009 Entity Secured Borrowing Obligation are reviewed periodically and updated accordingly, which may result in an adjustment to the expected life of the 2009 Entity Secured Borrowing Obligation and the related recognized interest expense.

**4. New Accounting Guidance**

In April 2015, the FASB issued Accounting Standards Update ( ASU ) No. 2015-03, Simplifying the Presentation of Debt Issuance Costs , which is included in the Codification under ASC 835, Interest ( ASC 835 ). This guidance requires that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of that liability. This guidance will be effective for our interim and annual reporting periods beginning January 1, 2016, with early adoption permitted. We are assessing the impact that this guidance may have on our consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, Amendment to the Consolidation Analysis ( ASU 2015-02 ), which is included in the Codification under ASC 810. This guidance changes the analysis that an entity must perform to determine whether it should consolidate certain types of legal entities. This guidance will be effective for our interim and annual reporting periods beginning January 1, 2016, with early adoption permitted. We are assessing the impact that this guidance may have on our consolidated financial statements.

In January 2015, the FASB issued ASU No. 2015-01, Income Statement Extraordinary and Unusual Items ( ASU 2015-01 ), which is included in the Codification under ASC 225, Income Statement ( ASC 225 ). This guidance eliminates the concept of extraordinary items from GAAP. This guidance will be effective for our interim and annual reporting periods beginning January 1, 2016, with early adoption permitted. We are assessing the impact that this guidance may have on our consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements Going Concern ( ASU 2014-15 ), which is included in the Codification under ASC 205, Presentation of Financial Statements ( ASC 205 ). This guidance was issued to define management s responsibility to evaluate whether there is substantial doubt about an entity s ability to continue as a going concern and to provide related footnote disclosure in certain circumstances. Under the new guidance, management is required to evaluate, at each annual and interim reporting period, whether there are conditions or events that raise substantial doubt about the entity s ability to continue as a going concern within one year after the date the financial statements are issued and to provide related disclosures. The guidance will be effective for our interim and annual reporting periods beginning January 1, 2017, with early adoption permitted. We are assessing the impact that this guidance may have on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers ( ASU 2014-09 ), which is included in the Codification under ASC 606, Revenue Recognition ( ASC 606 ). This guidance requires the recognition of revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration expected in exchange for those goods or services. This guidance will become effective for our interim and annual reporting periods beginning January 1, 2017. Early adoption is not permitted. We are assessing the impact that this guidance may have on our consolidated financial statements.

In April 2014, the FASB issued ASU No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity ( ASU 2014-08 ), which is included in the Codification under ASC 205, Presentation of Financial Statements ( ASC 205 ). This update changes the requirements for reporting discontinued operations and clarifies when disposals of groups of assets qualify for a discontinued operations presentation under ASC 205. This guidance became effective for our interim and annual reporting periods beginning January 1, 2015. Early adoption was permitted, but only for disposals that have not been reported in financial statements previously issued. We do not expect the adoption of ASU 2014-08 to have a material impact on our consolidated financial statements.

Table of Contents

In July 2013, the FASB issued ASU No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ( ASU 2013-11 ), which is included in the Codification under ASC 740. This update provides guidance on the financial statement presentation of unrecognized tax benefits when net operating loss carryforwards, similar tax losses or tax credit carryforwards exist. This guidance became effective for our interim and annual reporting periods beginning January 1, 2014. The adoption of this guidance did not have a material impact on our consolidated financial statements.

## 5. Acquisition

On January 31, 2014, we acquired certain assets and assumed certain liabilities of CompetenC Solutions, Inc. and Great Equalizer, Inc. for approximately $5,220, of which $5,186 was paid in the nine months ended September 30, 2014 and the remaining $34 was paid by October 31, 2014. CompetenC Solutions, Inc. and Great Equalizer, Inc. were education companies that operated primarily under the name of Ascolta and offered short-term information technology and business learning solutions for career advancers and other professionals. The acquisition of the Ascolta business allowed us to expand our offerings in the short-term learning solutions market by integrating the Ascolta operations into the Center for Professional Development @ ITT Technical Institute.

Our condensed consolidated financial statements include the results of the Ascolta business beginning as of the acquisition date. The revenue and expenses of the Ascolta business included in our Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2014 were not significant. Our revenue, net income and earnings per share would not have been materially affected, if the revenue and expenses of the Ascolta business were presented for the three and nine months ended September 30, 2014 and 2013 as if the transaction had occurred at the beginning of the earliest period presented. The costs incurred to acquire the Ascolta business were expensed and were not significant.

We accounted for the acquisition of the Ascolta business in accordance with ASC 805, Business Combinations ( ASC 805 ), which requires the use of the acquisition method of accounting for all business combinations. We considered the report of a third-party valuation firm in allocating the purchase price to identifiable net assets. The excess of the consideration paid over the estimated fair values of the identifiable net assets acquired was recognized as goodwill and is expected to be deductible for income tax purposes. The identifiable intangible assets acquired consist of customer relationships and non-compete agreements, which are being amortized over a weighted-average life of approximately five years.

The following table sets forth the estimated fair values allocated to the major classes of assets acquired and liabilities assumed in the Ascolta business acquisition as of the acquisition date:

| | Assets Acquired | Liabilities Assumed |
|---|---|---|
| Accounts receivable and other current assets | $ 849 | |
| Furniture and equipment | 370 | |
| Identifiable intangible assets | 1,670 | |
| Goodwill | 3,332 | |
| Other liabilities | | $ 1,001 |

**6. Goodwill and Intangibles**

We recognized goodwill and certain other intangible assets on our consolidated balance sheet as a result of the acquisition of:

- certain assets and liabilities of CompetenC Solutions, Inc. and Great Equalizer, Inc. on January 31, 2014;
- the membership interests of Cable Holdings, Inc. on August 1, 2013; and
- substantially all the assets and certain liabilities of Daniel Webster College on June 10, 2009.

The acquired intangible assets consist of certain identifiable intangible assets that are amortized over the asset s estimated life, and indefinite-lived intangible assets, including goodwill. Goodwill represents the excess of the consideration paid over the estimated fair value of identifiable net assets acquired.

Table of Contents

The following tables set forth the carrying value of our acquired intangible assets that are included in Other assets on our Condensed Consolidated Balance Sheets as of the dates indicated:

| | As of September 30, 2014 | | | |
|---|---|---|---|---|
| | Gross Carrying Value | Accumulated Amortization | Net Carrying Value | Weighted Average Amortization Period (months) |
| Amortizable intangible assets: | | | | |
| Customer relationships | $ 2,500 | $ (453) | $ 2,047 | 60 |
| Non-compete agreements | 1,120 | (224) | 896 | 60 |
| Training materials | 440 | (147) | 293 | 42 |
| Accreditation | 210 | (158) | 52 | 84 |
| | $ 4,270 | $ (982) | $ 3,288 | |
| Indefinite-lived intangible assets: | | | | |
| Goodwill | $ 7,247 | | | |
| Trademark | 660 | | | |
| | $ 7,907 | | | |

| | As of September 30, 2013 | | | |
|---|---|---|---|---|
| | Gross Carrying Value | Accumulated Amortization | Net Carrying Value | Weighted Average Amortization Period (months) |
| Amortizable intangible assets: | | | | |
| Customer relationships | $ 1,200 | $ (40) | $ 1,160 | 60 |
| Non-compete agreements | 750 | (25) | 725 | 60 |
| Training materials | 440 | (21) | 419 | 42 |
| Accreditation | 210 | (128) | 82 | 84 |
| | $ 2,600 | $ (214) | $ 2,386 | |
| Indefinite-lived intangible assets: | | | | |
| Goodwill | $ 3,958 | | | |
| Trademark | 660 | | | |
| | $ 4,618 | | | |

All amortizable intangible assets are being amortized on a straight-line basis. Amortization expense for amortized intangible assets was:

$193 in the three months ended September 30, 2014;

$8 in the three months ended September 30, 2013;

$632 in the nine months ended September 30, 2014; and

$23 in the nine months ended September 30, 2013.

The following table sets forth our estimate of the amortization expense for our amortizable intangible assets in each of the next five fiscal years:

| **Fiscal Year Ending December 31,** | **Estimated Amortization Expense** |
|---|---|
| 2015 | $ 880 |
| 2016 | 865 |
| 2017 | 734 |
| 2018 | 562 |
| 2019 | 28 |
| | $ 3,069 |

Indefinite-lived intangible assets include trademarks and goodwill, which are not amortized, since there are no legal, regulatory, contractual, economic or other factors that limit the useful life of those intangible assets by us.

Intangible assets that are not subject to amortization are required to be tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset may be impaired. We performed our annual impairment test as of October 1, 2014 and determined that certain of our indefinite-lived intangible assets were impaired, because the carrying value of those assets exceeded their estimated fair value. We believe that we may record a charge of approximately $2,000 in the fourth quarter of 2014 for the impairment of goodwill associated with the acquisitions of Cable Holdings and Ascolta. This impairment was due to a decrease in the fair value of the forecasted cash flows, primarily resulting from lower projected revenue and margins.

In addition to our annual impairment test, we consider certain triggering events when evaluating whether an interim impairment analysis is warranted. Among these are a significant long-term decrease in our market capitalization based on events specific to our operations. Deteriorating operating results and current period and projected future operating results that negatively differ from the operating plans used in the most recent impairment analysis (or initial allocation of purchase price) are also triggering events that could be cause for an interim impairment review. In our analysis of triggering events we also consider changes in the accreditation, regulatory or legal environment; increased competition; innovation changes and changes in the market acceptance of our educational programs and the graduates of those programs, among other factors. We concluded that no triggering event had occurred during the three and nine month periods ended September 30, 2014.

## 7. Fair Value

Fair value for financial reporting is defined as the price that would be received upon the sale of an asset or paid upon the transfer of a liability in an orderly transaction between market participants at the measurement date. The fair value measurement of our financial assets utilized assumptions categorized as observable inputs under the accounting guidance. Observable inputs are assumptions based on independent market data sources.

The following table sets forth information regarding the recurring fair value measurement of our financial assets as reflected on our Condensed Consolidated Balance Sheet as of September 30, 2014:

| | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| **Description** | **As of September 30, 2014** | **(Level 1) Quoted Prices in Active Markets for Identical Assets** | **(Level 2) Significant Other Observable Inputs** | **(Level 3) Significant Unobservable Inputs** |
| Cash equivalents: | | | | |
| Money market fund | $ 196,171 | $ 196,171 | $ 0 | $ 0 |
| Restricted cash: | | | | |
| Money market fund | 1,786 | 1,786 | 0 | 0 |
| Other assets: | | | | |
| Money market fund | 8,627 | 8,627 | 0 | 0 |
| | $ 206,584 | $ 206,584 | $ 0 | $ 0 |

The following table sets forth information regarding the recurring fair value measurement of our financial assets as reflected on our Condensed Consolidated Balance Sheet as of September 30, 2013:

| | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| **Description** | **As of September 30, 2013** | **(Level 1) Quoted Prices in Active Markets for Identical Assets** | **(Level 2) Significant Other Observable Inputs** | **(Level 3) Significant Unobservable Inputs** |
| Cash equivalents: | | | | |
| Money market fund | $ 163,981 | $ 163,981 | $ 0 | $ 0 |
| Restricted cash: | | | | |
| Money market fund | 3,140 | 3,140 | 0 | 0 |
| Other assets: | | | | |
| Money market fund | 8,625 | 8,625 | 0 | 0 |
| | $ 175,746 | $ 175,746 | $ 0 | $ 0 |

We used quoted prices in active markets for identical assets as of the measurement date to value our financial assets that were categorized as Level 1.

The carrying value for cash and cash equivalents, restricted cash, accounts receivable, accounts payable and other current liabilities approximate fair value, because of the immediate or short-term maturity of these financial instruments. We did not have any

15

Table of Contents

financial assets or liabilities recorded at estimated fair value on a non-recurring basis on our Condensed Consolidated Balance Sheet as of September 30, 2013. In accordance with ASC 810, the consolidation of the 2009 Entity was treated as an acquisition of assets and liabilities and, therefore, the assets and liabilities of the 2009 Entity were included on our Condensed Consolidated Balance Sheet as of September 30, 2014 at their estimated fair value. See Note 9 Variable Interest Entities for a further discussion of the estimated fair value of the assets and liabilities recorded.

As of September 30, 2014, the aggregate carrying value of the private education loans ( PEAKS Trust Student Loans and, together with the 2009 Entity Student Loans, the Private Education Loans ) owned by a trust (the PEAKS Trust ) that purchased, owns and collects private education loans made under the PEAKS Private Student Loan Program (the PEAKS Program ) was $67,412 and the estimated fair value was approximately $79,412. As of September 30, 2013, the carrying value of the PEAKS Trust Student Loans was $92,938 and the estimated fair value was approximately $109,000. The fair value of the PEAKS Trust Student Loans was estimated using the income approach with estimated discounted expected cash flows. We utilized inputs that were unobservable in determining the estimated fair value of the PEAKS Trust Student Loans. The significant inputs used in determining the estimated fair value included the default rate, repayment rate and discount rate. Fair value measurements that utilize significant unobservable inputs are categorized as Level 3 measurements under the accounting guidance.

Each of the carrying value and the estimated fair value of our debt under our credit agreement was approximately $50,000 as of September 30, 2014, $50,000 as of December 31, 2013 and $60,000 as of September 30, 2013. The fair value of our debt under our credit agreement was estimated by discounting the future cash flows using current rates for similar loans with similar characteristics and remaining maturities. We utilized inputs that were observable or were principally derived from observable market data to estimate the fair value of our debt under our credit agreement. Fair value measurements that utilize significant other observable inputs are categorized as Level 2 measurements under the accounting guidance.

As of September 30, 2014, the carrying value of the senior debt issued by the PEAKS Trust in the initial aggregate principal amount of $300,000 (the PEAKS Senior Debt ) was $149,836 and the estimated fair value was approximately $149,583. As of September 30, 2013, the carrying value of the PEAKS Senior Debt was $228,495 and the estimated fair value was approximately $233,000. The fair value of the PEAKS Senior Debt was estimated using the income approach with estimated discounted cash flows. We utilized inputs that were unobservable in determining the estimated fair value of the PEAKS Senior Debt. The significant input used in determining the estimated fair value was the discount rate utilized for both credit and liquidity purposes. Fair value measurements that utilize significant unobservable inputs are categorized as Level 3 measurements under the accounting guidance.

Financial instruments that potentially subject us to credit risk consist primarily of accounts receivable, cash equivalents and the Private Education Loans. There is no concentration of credit risk of our accounts receivable, as the total is comprised of a large number of individual balances owed by students whose credit profiles vary and who are located throughout the United States. Our cash equivalents generally consist of money market funds which invest in high-quality securities issued by various entities. The Private Education Loans consist of a large number of individual loans owed by borrowers, whose credit profiles vary and who are located throughout the United States.

## 8. Equity Compensation

The stock-based compensation expense and related income tax benefit recognized in our Condensed Consolidated Statements of Income in the periods indicated were as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Stock-based compensation expense | $ 2,667 | $ 3,304 | $ 7,529 | $ 8,698 |
| Income tax (benefit) | $ (1,027) | $ (1,272) | $ (2,899) | $ (3,349) |

As of September 30, 2014, we estimated that pre-tax compensation expense for unvested stock-based compensation grants in the amount of approximately $12,300, net of estimated forfeitures, will be recognized in future periods. This expense will be recognized over the remaining service period applicable to the grantees which, on a weighted-average basis, is approximately 1.7 years.

Table of Contents

The stock options granted, forfeited, exercised and expired in the period indicated were as follows:

| | Nine Months Ended September 30, 2014 | | | | |
|---|---|---|---|---|---|
| | # of Shares | Weighted Average Exercise Price | Aggregate Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value (1) |
| Outstanding at beginning of period | 1,332,448 | $ 81.77 | $ 108,955 | | |
| Granted | 168,500 | $ 27.94 | 4,708 | | |
| Forfeited | (10,334) | $ 30.29 | (313) | | |
| Exercised | 0 | $ 0 | 0 | | |
| Expired | (322,441) | $ 70.87 | (22,853) | | |
| Outstanding at end of period | 1,168,173 | $ 77.47 | $ 90,497 | 2.4 | $ 0 |
| Exercisable at end of period | 862,165 | $ 93.85 | $ 80,911 | 2.0 | $ 0 |

(1) The aggregate intrinsic value of the stock options was calculated by identifying those stock options that had a lower exercise price than the closing market price of our common stock on September 30, 2014 and multiplying the difference between the closing market price of our common stock and the exercise price of each of those stock options by the number of shares subject to those stock options that were outstanding or exercisable, as applicable. Since the closing market price of our common stock on September 30, 2014 was lower than the exercise price of all outstanding stock options and exercisable stock options, the aggregate intrinsic value of the stock options was zero.

The following table sets forth information regarding the stock options granted and exercised in the periods indicated:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Shares subject to stock options granted | 0 | 0 | 168,500 | 154,000 |
| Weighted average grant date fair value per share | $ 0 | $ 0 | $ 12.62 | $ 9.16 |
| Shares subject to stock options exercised | 0 | 0 | 0 | 0 |
| Intrinsic value of stock options exercised | $ 0 | $ 0 | $ 0 | $ 0 |
| Proceeds received from stock options exercised | $ 0 | $ 0 | $ 0 | $ 0 |
| Tax benefits realized from stock options exercised | $ 0 | $ 0 | $ 0 | $ 0 |

The intrinsic value of a stock option is the difference between the fair market value of the stock and the option exercise price.

The fair value of each stock option grant was estimated on the date of grant using the following assumptions:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Risk-free interest rates | Not applicable | Not applicable | 1.3% | 0.7% |
| Expected lives (in years) | Not applicable | Not applicable | 4.7 | 4.6 |
| Volatility | Not applicable | Not applicable | 55% | 60% |
| Dividend yield | Not applicable | Not applicable | None | None |

17

Table of Contents

The following table sets forth the number of restricted stock units ( RSUs ) that were granted, forfeited and vested in the period indicated:

| | Nine Months Ended September 30, 2014 | |
|---|---|---|
| | # of RSUs | Weighted Average Grant Date Fair Value |
| Unvested at beginning of period | 737,844 | $ 39.96 |
| Granted | 402,890 | $ 21.46 |
| Forfeited | (156,315) | $ 31.42 |
| Vested | (119,560) | $ 61.07 |
| Unvested at end of period | 864,859 | $ 29.97 |

The total fair market value of the RSUs that vested and were settled in shares of our common stock was:

- $563 in the three months ended September 30, 2014;
- $49 in the three months ended September 30, 2013;
- $2,505 in the nine months ended September 30, 2014; and
- $1,226 in the nine months ended September 30, 2013.

**9. <u>Variable Interest Entities</u>**

Under ASC 810, an entity that holds a variable interest in a VIE and meets certain requirements would be considered to be the primary beneficiary of the VIE and required to consolidate the VIE in its consolidated financial statements. In order to be considered the primary beneficiary of a VIE, an entity must hold a variable interest in the VIE and have both:

- the power to direct the activities that most significantly impact the economic performance of the VIE; and
- the right to receive benefits from, or the obligation to absorb losses of, the VIE that could be potentially significant to the VIE.

We hold variable interests in the PEAKS Trust as a result of:

- a subordinated note issued to us by the PEAKS Trust in exchange for the portion of each private education loan disbursed to us under the PEAKS Program that we transferred to the PEAKS Trust ( Subordinated Note ); and

- our guarantee of the payment of the principal and interest owed on the PEAKS Senior Debt, the administrative fees and expenses of the PEAKS Trust and a minimum required ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt ( PEAKS Guarantee ).

We hold variable interests in the 2009 Entity as a result of:

- the 2009 RSA; and

- a revolving note owed to us by the 2009 Entity (the Revolving Note ).

*Primary Beneficiary Analysis*. The PEAKS Trust and the 2009 Entity are VIEs as defined under ASC 810. To determine whether we are the primary beneficiary of the PEAKS Trust or the 2009 Entity, we:

- assessed the risks that the VIE was designed to create and pass through to its variable interest holders;

- identified the variable interests in the VIE;

- identified the other variable interest holders and their involvement in the activities of the VIE;

- identified the activities that most significantly impact the VIE s economic performance;

- determined whether we have the power to direct those activities; and

- determined whether we have the right to receive the benefits from, or the obligation to absorb the losses of, the VIE that could potentially be significant to the VIE.

We determined that the activities of the PEAKS Trust and the 2009 Entity that most significantly impact the economic performance of the PEAKS Trust and the 2009 Entity involve the servicing (which includes the collection) of the PEAKS Trust Student Loans and the 2009 Entity Student Loans. To make that determination, we analyzed various possible scenarios of student loan portfolio performance to evaluate the potential economic impact on the PEAKS Trust and the 2009 Entity. In our analysis, we made what we believe are reasonable assumptions based on historical data for the following key variables:

- the composition of the credit profiles of the borrowers;

- the interest rates and fees charged on the loans;

- the default rates and the timing of defaults associated with similar types of loans; and

- the prepayment and the speed of repayment associated with similar types of loans.

Based on our analysis, we concluded that we became the primary beneficiary of the PEAKS Trust on February 28, 2013. This was the first date that we had the power to direct the activities of the PEAKS Trust that most significantly impact the economic

Table of Contents

performance of the PEAKS Trust, because we could have exercised our right to terminate the servicing agreement that governs the servicing activities of the PEAKS Trust Student Loans (the PEAKS Servicing Agreement ), due to the failure of the entity that performs those servicing activities for the PEAKS Trust Student Loans on behalf of the PEAKS Trust to meet certain performance criteria specified in the PEAKS Servicing Agreement. We have not, however, exercised our right to terminate the PEAKS Servicing Agreement. As a result of our primary beneficiary conclusion, we consolidated the PEAKS Trust in our consolidated financial statements beginning on February 28, 2013 (the PEAKS Consolidation ). Prior to February 28, 2013, the PEAKS Trust was not required to be consolidated in our consolidated financial statements, because we concluded that we were not the primary beneficiary of the PEAKS Trust prior to that time. The PEAKS Trust is discussed in more detail below.

Our consolidated financial statements for periods as of and after February 28, 2013 include the PEAKS Trust, because we were considered to have control over the PEAKS Trust beginning on February 28, 2013 under ASC 810, as a result of our substantive unilateral right to terminate the PEAKS Servicing Agreement. We do not, however, actively manage the operations of the PEAKS Trust, and the assets of the consolidated PEAKS Trust can only be used to satisfy the obligations of the PEAKS Trust. Our obligations under the PEAKS Guarantee remain in effect, until the PEAKS Senior Debt and the PEAKS Trust s fees and expenses are paid in full. See Note 14 Commitments and Contingencies, for a further discussion of the PEAKS Guarantee.

Based on our analysis, we concluded that we became the primary beneficiary of the 2009 Entity on September 30, 2014. This was the first date that we determined we had the power to direct the activities of the 2009 Entity that most significantly impact the economic performance of the 2009 Entity, because the entity that performs the servicing activities on behalf of the 2009 Entity (the 2009 Loan Program Servicer ) failed to meet certain performance criteria specified in the servicing agreement that governs the servicing activities of the 2009 Entity Student Loans (the 2009 Entity Servicing Agreement ) on that date. The 2009 Entity Servicing Agreement provides that in the event that the 2009 Loan Program Servicer fails to meet certain performance criteria specified in the 2009 Entity Servicing Agreement, and the 2009 Loan Program Servicer does not affect a cure of that failure during a specified cure period, we would have the right to terminate the 2009 Servicing Agreement. We determined that it was not reasonably possible that the 2009 Loan Program Servicer would be able to affect a cure during the specified cure period and, therefore, because the cure period was not substantive, we effectively had the right to terminate the 2009 Servicing Agreement as of the date that the 2009 Loan Program Servicer failed to meet the performance criteria. We have not, however, exercised our right to terminate the 2009 Entity Servicing Agreement.

As a result of our primary beneficiary conclusion, we consolidated the 2009 Entity in our consolidated financial statements beginning on September 30, 2014. Prior to September 30, 2014, the 2009 Entity was not required to be consolidated in our consolidated financial statements, because we concluded that we were not the primary beneficiary of the 2009 Entity. The 2009 Entity is discussed in more detail below.

Our consolidated financial statements for periods as of and after September 30, 2014 include the 2009 Entity, because we were considered to have control over the 2009 Entity under ASC 810, as a result of our substantive right to terminate the 2009 Entity Servicing Agreement after a cure period that was not substantive. We do not, however, actively manage the operations of the 2009 Entity, and the assets of the consolidated 2009 Entity can only be used to satisfy the obligations of the 2009 Entity. Our obligations under the 2009 RSA remain in effect, until all 2009 Entity Student Loans are paid in full. See Note 14 Commitments and Contingencies, for a further discussion of the 2009 RSA.

The PEAKS Trust and the 2009 Entity are not included in our consolidated income tax returns. We do not recognize income tax expense or benefit for the financial results of the PEAKS Trust or the 2009 Entity in the provision for income taxes included in our Condensed Consolidated Statements of Income, even though the PEAKS Trust and the

2009 Entity are included in our consolidated financial statements. Because the PEAKS Trust generated a loss in the three and nine months ended September 30, 2013 that we could not recognize an income tax benefit for, our effective income tax rate was affected. In the three and nine months ended September 30, 2014, the financial results of the PEAKS Trust and 2009 Entity were not significant and, therefore, did not have a significant impact on our effective income tax rate. Our deferred income tax assets as of September 30, 2014 were lower as compared to December 31, 2013, primarily due to the significant payments that we made under the PEAKS Guarantee and 2009 RSA, which are generally deductible for income tax purposes when the payments are made.

***PEAKS Private Student Loan Program.*** On January 20, 2010, we entered into agreements with unrelated third parties to establish the PEAKS Program, which was a private education loan program for our students. We entered into the PEAKS Program to offer our students another source of private education loans that they could use to help pay their education costs owed to us and to supplement the limited amount of private education loans available to our students under other private education loan programs, including the 2009 Loan Program. Under the PEAKS Program, our students had access to a greater amount of private education loans, which resulted in a reduction in the amount of internal financing that we provided to our students in 2010 and 2011. No new private education loans were or will be originated under the PEAKS Program after July 2011, but immaterial amounts related to loans originated prior to that date were disbursed by the lender through March 2012.

Under the PEAKS Program, an unrelated lender originated private education loans to our eligible students and, subsequently, sold those loans to the PEAKS Trust. The PEAKS Trust issued the PEAKS Senior Debt to investors. The lender disbursed the proceeds of the private education loans to us for application to the students account balances with us that represented their unpaid education costs. We transferred a portion of the amount of each private education loan disbursed to us under the PEAKS Program to the PEAKS Trust in exchange for the Subordinated Note.

The Subordinated Note issued by the PEAKS Trust to us does not bear interest and matures in March 2026. Principal is due on the Subordinated Note following:

- the repayment of the PEAKS Senior Debt;
- the repayment of fees and expenses of the PEAKS Trust; and
- the reimbursement of the amounts of any payments made by us under the PEAKS Guarantee, other than Payments on Behalf of Borrowers (as defined below).

The carrying value of the Subordinated Note was eliminated from our consolidated balance sheet when we consolidated the PEAKS Trust in our consolidated financial statements beginning on February 28, 2013. In the three months ended December 31, 2012, we determined it was probable that we would not collect the carrying value of the Subordinated Note and, therefore, recorded an impairment charge for the total carrying value of the Subordinated Note.

The PEAKS Trust utilized the proceeds from the issuance of the PEAKS Senior Debt and the Subordinated Note to purchase the private education loans made by the lender to our students. The assets of the PEAKS Trust (which include, among other assets, the PEAKS Trust Student Loans) serve as collateral for, and are intended to be the principal source of, the repayment of the PEAKS Senior Debt and the Subordinated Note.

Under the PEAKS Guarantee, we guarantee payment of the principal and interest owed on the PEAKS Senior Debt, the administrative fees and expenses of the PEAKS Trust and a minimum required ratio of assets of the PEAKS Trust to outstanding PEAKS Senior Debt (the Asset/Liability Ratio ). Our guarantee obligations under the PEAKS Program remain in effect until the PEAKS Senior Debt and the PEAKS Trust s fees and expenses are paid in full. At such time, we will be entitled to repayment of the amounts we paid under the PEAKS Guarantee (which do not include Payments on Behalf of Borrowers, as defined below), to the extent of available funds remaining in the PEAKS Trust. See Note 14 Commitments and Contingencies, for a further discussion of our obligations to make guarantee payments pursuant to the PEAKS Guarantee.

*Assets and Liabilities of PEAKS Trust*. We concluded that we became the primary beneficiary of the PEAKS Trust on February 28, 2013 and, therefore, were required to consolidate the PEAKS Trust in our consolidated financial statements. In accordance with ASC 810, the consolidation of the PEAKS Trust was treated as an acquisition of assets and liabilities and, therefore, the assets and liabilities of the PEAKS Trust were included in our consolidated financial statements at their fair value as of February 28, 2013. The following table sets forth the fair value of the assets and liabilities of the PEAKS Trust as of February 28, 2013 that were included on our consolidated balance sheet on that date:

| | As of February 28, 2013 | |
|---|---|---|
| | **Assets** | **Liabilities** |
| Restricted cash | $ 1,703 | |
| Current portion of PEAKS Trust student loans | 7,282 | |

| | | |
|---|---|---|
| PEAKS Trust student loans, excluding current portion | 104,834 | |
| Current portion of PEAKS Trust senior debt | | $ 103,356 |
| Other current liabilities | | 471 |
| PEAKS Trust senior debt, excluding current portion | | 122,740 |
| Total | $ 113,819 | $ 226,567 |

The following table sets forth the carrying value of the assets and liabilities related to the PEAKS Program as of February 28, 2013 that we eliminated from our consolidated balance sheet when we consolidated the PEAKS Trust in our consolidated financial statements, and the line items within which those assets and liabilities were included:

| | **As of February 28, 2013** | |
|---|---|---|
| | **Assets** | **Liabilities** |
| Other assets | $ 6,614 | |
| Other current liabilities | | $ 3,060 |
| Other liabilities | | 43,054 |
| Total | $ 6,614 | $ 46,114 |

The fair value of the PEAKS Trust s liabilities exceeded the fair value of the PEAKS Trust s assets as of February 28, 2013 by $112,748. The amount of this excess was reduced by $39,500, which represented the net amount of the carrying value of the assets and liabilities related to the PEAKS Program that had been recorded in our consolidated financial statements as of February 28, 2013 and were eliminated upon the PEAKS Consolidation. As a result, we recognized a total loss of $73,248 in our Condensed Consolidated Statement of Income for the three months ended March 31, 2013 related to the PEAKS Consolidation.

Table of Contents

The following table sets forth the carrying value of assets and liabilities of the PEAKS Trust that were included on our Condensed Consolidated Balance Sheets as of the dates indicated:

| | As of September 30, 2014 | As of December 31, 2013 | As of September 30, 2013 |
|---|---|---|---|
| **Assets** | | | |
| Restricted cash | $ 1,450 | $ 2,593 | $ 1,237 |
| Current portion of PEAKS Trust student loans | 6,933 | 7,730 | 7,598 |
| PEAKS Trust student loans, excluding current portion, less allowance for loan losses of $42,931, $29,349 and $20,701 | 60,479 | 76,479 | 85,340 |
| Total assets | $ 68,862 | $ 86,802 | $ 94,175 |
| **Liabilities** | | | |
| Current portion of PEAKS Trust senior debt | $ 96,516 | $ 157,883 | $ 134,075 |
| Other current liabilities | 287 | 697 | 496 |
| PEAKS Trust senior debt, excluding current portion | 53,320 | 71,341 | 94,420 |
| Total liabilities | $ 150,123 | $ 229,921 | $ 228,991 |

The assets of the PEAKS Trust can only be used to satisfy the obligations of the PEAKS Trust. Payment of the administrative fees and expenses of the PEAKS Trust and the principal and interest owed on the PEAKS Senior Debt are guaranteed by us under the PEAKS Guarantee.

*Revenue and Expenses of PEAKS Trust*. The following table sets forth the revenue and expenses of the PEAKS Trust, excluding the loss on consolidation of the PEAKS Trust, which were included in our Condensed Consolidated Statements of Income for the periods indicated:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Revenue | $ 2,727 | $ 4,072 | $ 9,099 | $ 9,536 |
| Student services and administrative expenses | 987 | 1,535 | 3,624 | 3,613 |
| Provision for PEAKS Trust student loan losses | 4,511 | 16,382 | 13,582 | 20,701 |
| Interest expense | 8,722 | 6,275 | 26,195 | 14,953 |
| (Loss) before provision for income taxes | $ (11,493) | $ (20,120) | $ (34,302) | $ (29,731) |

The revenue of the PEAKS Trust consists of interest income on the PEAKS Trust Student Loans, which is the accretion of the accretable yield on the PEAKS Trust Student Loans. The servicing, administrative and other fees incurred by the PEAKS Trust are included in Student services and administrative expenses in our Condensed Consolidated Statements of Income. The provision for PEAKS Trust student loan losses represents the increase in the allowance for loan losses that occurred during the period. The allowance for loan losses represents the difference between the carrying value and the total present value of the expected principal and interest collections of each loan pool of the PEAKS Trust Student Loans, discounted by the loan pool s effective interest rate as of the end of the reporting period. Interest expense of the PEAKS Trust represents interest expense on the PEAKS Senior Debt, which includes the contractual interest obligation and the accretion of the discount on the PEAKS Senior Debt.

*Payments on Behalf of Borrowers*. Beginning in the fourth quarter of 2012 and continuing through January 2014, we made payments on behalf of certain student borrowers under the PEAKS Program to the PEAKS Trust to avoid defaults by those borrowers on their PEAKS Trust Student Loans ( Payments on Behalf of Borrowers ), which defaults would have triggered much larger contractually required payments by us under the PEAKS Guarantee. At the time we made Payments on Behalf of Borrowers, we believed that those payments were contractually permitted and a form of payment to the PEAKS Trust that would satisfy obligations that were contractually required. Since that time, however, we have determined that Payments on Behalf of Borrowers are not permitted or required to support the PEAKS Trust. If we had not made Payments on Behalf of Borrowers, we would have had to make contractually required payments under the PEAKS Guarantee in greater amounts. We made Payments on Behalf of Borrowers after assessing:

- the likelihood of us being contractually required to make payments under the PEAKS Guarantee in the near future;

- the effect on our liquidity that would result from making payments under the PEAKS Guarantee compared to making Payments on Behalf of Borrowers;

- the effect that Payments on Behalf of Borrowers may have on the funds available to the PEAKS Trust to repay the Subordinated Note to us following full payment of the PEAKS Trust s other obligations; and

- the fact that we will not be able to recover Payments on Behalf of Borrowers from the PEAKS Trust or the student borrowers on whose behalf we made those payments.

Table of Contents

Payments on Behalf of Borrowers assisted in:

- maintaining the Asset/Liability Ratio at the required level; and
- satisfying the following month s required payment of interest on the PEAKS Senior Debt and administrative fees and expenses of the PEAKS Trust.

Prior to the PEAKS Consolidation, Payments on Behalf of Borrowers were reflected on our financial statements as a reduction to our contingent liability. Following the PEAKS Consolidation, Payments on Behalf of Borrowers were not reflected on our financial statements, since those payments were intercompany transactions that were eliminated from our financial statements as a result of the PEAKS Consolidation.

In January 2014, we made Payments on Behalf of Borrowers of $1,832. We entered into a letter agreement, dated as of March 17, 2014, with the trustee under the PEAKS Program and the holders of the PEAKS Senior Debt (the PEAKS Letter Agreement ), in order to resolve differing interpretations of the permissibility of the Payments on Behalf of Borrowers under the PEAKS Program documents. Pursuant to the PEAKS Letter Agreement, the trustee agreed to waive, and the holders of the PEAKS Senior Debt consented to the waiver of, any:

- breach of the PEAKS Program documents caused by us making Payments on Behalf of Borrowers, including any failure to make payments under the PEAKS Guarantee as a result thereof; and
- event of default under the PEAKS Program documents that may have arisen or resulted by us making Payments on Behalf of Borrowers.

In the PEAKS Letter Agreement, we agreed that, after the date of the PEAKS Letter Agreement, we would not make any further payments of any kind on behalf of any borrower in respect of a private education loan made under the PEAKS Program, and that any such payments in lieu of making payments to maintain the applicable required Asset/Liability Ratio would constitute a breach of the terms of the PEAKS Guarantee and an event of default under the indenture and credit agreement for the PEAKS Program. In accordance with the terms of the PEAKS Letter Agreement, we paid $40,000 on March 20, 2014, which is considered to be a payment under the PEAKS Guarantee and was applied primarily to make a mandatory prepayment of the PEAKS Senior Debt.

*PEAKS Guarantee Payments and Payments on Behalf of Borrowers*. The following table sets forth the PEAKS Guarantee payments and Payments on Behalf of Borrowers that were made in the periods indicated:

| | **Three Months Ended September 30,** | | **Nine Months Ended September 30,** | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| PEAKS Guarantee | $ 52,517 | $ 138 | $ 94,318 | $ 1,377(1) |
| Payments on Behalf of Borrowers | 0 | 2,502 | 1,832 | 7,647(2) |

| | | | | |
|---|---|---|---|---|
| Total | $ 52,517 | $ 2,640 | $ 96,150 | $ 9,024 |

(1) Of this amount, $854 was paid prior to the PEAKS Consolidation.
(2) Of this amount, $532 was paid prior to the PEAKS Consolidation.

***2009 Loan Program.*** On February 20, 2009, we entered into agreements with the 2009 Entity to create the 2009 Loan Program. Under the 2009 Loan Program, an unrelated lender originated private education loans to our eligible students and, subsequently, sold those loans to the 2009 Entity. The 2009 Entity purchased the private education loans from the lender utilizing funds received from its owners in exchange for participation interests in the private education loans acquired by the 2009 Entity. The lender disbursed the proceeds of the private education loans to us for application to the students account balances with us that represented their unpaid education costs. No new private education loans were or will be originated under the 2009 Loan Program after December 31, 2011, but immaterial amounts related to loans originated prior to that date were disbursed by the lender through June 2012.

In connection with the 2009 Loan Program, we entered into the 2009 RSA with the 2009 Entity. Under the 2009 RSA, we guarantee the repayment of any private education loans that are charged off above a certain percentage of the private education loans made under the 2009 Loan Program, based on the annual dollar volume. Under the 2009 RSA, we have an obligation to make the monthly payments due and unpaid on those private education loans that have been charged off above a certain percentage ( Regular Payments ). Instead of making Regular Payments, however, we may elect to discharge our obligations to make Regular Payments on specified charged-off private education loans by:

paying the then outstanding balance (plus accrued and unpaid interest) of those private education loans that have been charged off above a certain percentage and, with respect to which, an amount equal to at least ten monthly payments has been paid; or

paying the then outstanding balance (plus accrued and unpaid interest) of those private education loans that have been charged off above a certain percentage and, with respect to which, an amount equal to at least ten monthly payments has not been paid, plus any interest that would otherwise have been payable until ten monthly payments had been made, discounted at the rate of 10% per annum,

(collectively, Discharge Payments ).

See Note 14 Commitments and Contingencies, for a further discussion of our obligations to make guarantee payments pursuant to the 2009 RSA.

*Assets and Liabilities of 2009 Entity*. We concluded that we became the primary beneficiary of the 2009 Entity on September 30, 2014 and, therefore, were required to consolidate the 2009 Entity in our consolidated financial statements. In accordance with ASC 810, the consolidation of the 2009 Entity was treated as an acquisition of assets and liabilities and, therefore, the assets and liabilities of the 2009 Entity were included in our consolidated financial statements at their fair value as of September 30, 2014.

The fair value of the 2009 Entity Student Loans was estimated using the income approach with estimated discounted expected cash flows. We utilized inputs that were unobservable in determining the estimated fair value of the 2009 Entity Student Loans. The significant inputs used in determining the estimated fair value of the 2009 Entity Student Loans included the default rate, repayment rate and discount rate. The fair value of the 2009 Entity Secured Borrowing Obligation was estimated using the income approach with estimated discounted cash flows. We utilized inputs that were unobservable in determining the estimated fair value of the 2009 Entity Secured Borrowing Obligation. The significant input used in determining the estimated fair value of the 2009 Entity Secured Borrowing Obligation was the discount rate utilized for both credit and liquidity purposes. Fair value measurements that utilize significant unobservable inputs are categorized as Level 3 measurements under the accounting guidance.

The 2009 Entity Secured Borrowing Obligation represents the estimated amount that the 2009 Entity owes to the 2009 Entity Participants related to their participation interests in the 2009 Entity Student Loans, which amount is expected to be paid to the 2009 Entity Participants by the 2009 Entity from payments received by the 2009 Entity related to the 2009 Entity Student Loans, whether from the borrower or from us under the 2009 RSA.

In accordance with ASC 810, we included the 2009 Entity Secured Borrowing Obligation on our condensed consolidated balance sheet at its fair value as of September 30, 2014, the date of the 2009 Entity Consolidation. The difference between the estimated fair value of the 2009 Entity Secured Borrowing Obligation and the amount expected to be paid by the 2009 Entity to the 2009 Entity Participants was recorded as an accrued discount on our condensed consolidated balance sheet at the date of the 2009 Entity Consolidation. The accrued discount is being recognized in interest expense at a level rate of return over the expected life of the 2009 Entity Secured Borrowing Obligation.

The expected life of the 2009 Entity Secured Borrowing Obligation is an estimate of the period of time over which payments are expected to be made by the 2009 Entity to the 2009 Entity Participants related to their participation interests in the 2009 Entity Student Loans. The period of time over which payments are expected to be made by the 2009 Entity to the 2009 Entity Participants is based upon when the 2009 Entity Student Loans enter a repayment status and the period of time they remain in a repayment status. Since all of the 2009 Entity Student Loans have not entered repayment, and those loans that have entered a repayment status may be granted forbearances or deferments, the period of time over which payments are expected to be made to the 2009 Entity Participants is an estimate. The assumptions used to estimate the expected life of the 2009 Entity Secured Borrowing Obligation are reviewed periodically and updated accordingly, which may result in an adjustment to the expected life of the 2009 Entity Secured Borrowing Obligation and the related recognized interest expense.

The following table sets forth the fair value and the carrying value of the assets and liabilities of the 2009 Entity as of September 30, 2014 that were included on our Condensed Consolidated Balance Sheet on that date:

| | As of September 30, 2014 | |
|---|---|---|
| | Assets | Liabilities |
| Restricted cash | $ 2,738 | |
| Current portion of 2009 Entity Student Loans | 3,406 | |
| 2009 Entity Student Loans, excluding current portion | 23,793 | |
| Other assets | 199 | |
| Current portion of 2009 Entity Secured Borrowing Obligation | | $ 20,662 |
| Other current liabilities | | 624 |
| 2009 Entity Secured Borrowing Obligation, excluding current portion | | 101,880 |
| Other liabilities | | 1,940 |
| Total | $ 30,136 | $ 125,106 |

The assets of the 2009 Entity can only be used to satisfy the obligations of the 2009 Entity.

Table of Contents

The following table sets forth the carrying value of the assets and liabilities related to the 2009 Entity as of September 30, 2014 that we eliminated from our consolidated balance sheet when we consolidated the 2009 Entity in our consolidated financial statements, and the line items within which those assets and liabilities were included:

| | As of September 30, 2014 | |
|---|---|---|
| | Assets | Liabilities |
| Prepaid expenses and other current assets | $ 3,260 | |
| Other current liabilities | | $ 23,887 |
| Other liabilities | | 90,974 |
| Total | $ 3,260 | $ 114,861 |

Upon the 2009 Entity Consolidation, we recorded the 2009 Entity s assets and liabilities at their fair value in our consolidated financial statements and we eliminated the carrying value of the assets and liabilities related to the 2009 Loan Program that had been recorded in our consolidated financial statements as of September 30, 2014. The fair value of the 2009 Entity s liabilities exceeded the fair value of the 2009 Entity s assets as of September 30, 2014 by $94,970. As of September 30, 2014, the carrying value of the liabilities related to the 2009 Loan Program that had been recorded in our consolidated financial statements exceeded the carrying value of the assets related to the 2009 Loan Program that had been recorded in our consolidated financial statements by $111,601. As a result, we recognized a total gain of $16,631 in our Condensed Consolidated Statements of Income in the three and nine months ended September 30, 2014, which represented the difference between (i) the fair value of the net liabilities of the 2009 Entity that we recorded upon the 2009 Entity Consolidation, and (ii) the carrying value of the net liabilities related to the 2009 Loan Program that had been recorded in our consolidated financial statements and were eliminated upon the 2009 Entity Consolidation, in each case, as of September 30, 2014.

We did not recognize any revenue or expenses of the 2009 Entity, except for the gain on consolidation of the 2009 Entity, in our Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2014, because the 2009 Entity Consolidation was effective on September 30, 2014.

*2009 RSA Payments, Recoveries and Offsets*. Pursuant to the 2009 RSA, we are entitled to all amounts that the 2009 Entity recovers from loans in a particular loan pool made under the 2009 Loan Program that have been charged off, until all payments that we made under the 2009 RSA with respect to that loan pool have been repaid to us by the 2009 Entity. We have the right to offset payment amounts that we owe under the 2009 RSA by the amount of recoveries from charged-off loans made under the 2009 Loan Program that are owed, but have not been paid, to us. We exercised this offset right in the three and nine months ended September 30, 2014. We did not exercise this offset right in the three or nine months ended September 30, 2013.

The following table sets forth the payments that we made to the 2009 Entity related to our guarantee obligations under the 2009 RSA and the amount of recoveries from charged-off loans paid to us by the 2009 Entity in the periods indicated:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |

| | | | | |
|---|---|---|---|---|
| Regular Payments | $ 1,809[(1)] | $ 458 | $ 4,556[(1)] | $ 841 |
| Discharge Payments | 0 | 0 | 0 | 0 |
| Recoveries from Charged-Off Loans | 0 | 0 | 0 | (103) |
| Total | $ 1,809 | $ 458 | $ 4,556 | $ 738 |

(1) This amount is net of $156 of recoveries from charged-off loans owed to us that we offset against the amount we owed under the 2009 RSA.

The 2009 Entity did not remit to us, and we did not offset payments under the 2009 RSA for, the following amounts of recoveries from charged-off loans that were owed to us:

- $0 in the three months ended September 30, 2014;
- $186 in the three months ended September 30, 2013;
- $475 in the nine months ended September 30, 2014; and
- $413 in the nine months ended September 30, 2013.

We recorded the amount of recoveries from charged-off loans that were owed to us, but not paid or offset, as of September 30, 2013, in Prepaid expenses and other current assets on our Condensed Consolidated Balance Sheet. The amounts of recoveries from charged-off loans that were owed to us by the 2009 Entity, but not paid or offset, as of September 30, 2014 were not recorded on our consolidated financial statements, since those amounts were intercompany transactions that were eliminated from our financial statements as a result of the 2009 Entity Consolidation.

Table of Contents

We also offset the following amounts owed by us under the 2009 RSA against amounts owed to us by the 2009 Entity under the Revolving Note, instead of making additional payments in those amounts:

- $0 in the three months ended September 30, 2014;
- $357 in the three months ended September 30, 2013;
- $0 in the nine months ended September 30, 2014; and
- $8,471 in the nine months ended September 30, 2013.

We recorded the amounts that we claimed as offsets against amounts owed to us under the Revolving Note in Other current liabilities on our Condensed Consolidated Balance Sheet as of September 30, 2013. The amounts that we claimed as offsets under the Revolving Note as of September 30, 2014, were not recorded on our consolidated financial statements, since those amounts were intercompany transactions that were eliminated from our financial statements as a result of the 2009 Entity Consolidation.

See Note 14 Commitments and Contingencies, for a further discussion of the offsets and 2009 RSA.

We made advances to the 2009 Entity under the Revolving Note in years prior to 2012. We made the advances so that the 2009 Entity could use those funds primarily to provide additional funding to the 2009 Entity to purchase additional private education loans made under the 2009 Loan Program. The period of time during which we could make additional advances under the Revolving Note ended on January 1, 2014. We did not make any advances in the three or nine months ended September 30, 2013 to the 2009 Entity under the Revolving Note that we were not contractually required to make. Certain of the assets of the 2009 Entity serve as collateral for the Revolving Note. The Revolving Note bears interest, is subject to customary terms and conditions and is currently due and payable in full. The Revolving Note was eliminated from our financial statements as a result of the 2009 Entity Consolidation.

The amount owed to us under the Revolving Note, excluding the offsets described above, was approximately $8,200 as of September 30, 2014, December 31, 2013 and September 30, 2013.

**10. Private Education Loans**

We concluded that we were required to consolidate the PEAKS Trust in our consolidated financial statements beginning on February 28, 2013 and to consolidate the 2009 Entity in our consolidated financial statements beginning on September 30, 2014. See Note 9 Variable Interest Entities, for a further discussion of the consolidation of the PEAKS Trust and 2009 Entity (the Consolidated VIEs ). As a result, the assets and liabilities of the Consolidated VIEs were included on our Condensed Consolidated Balance Sheet as of September 30, 2014. The assets and liabilities of the PEAKS Trust were included on our Condensed Consolidated Balance Sheets as of December 31, 2013 and September 30, 2013.

As of September 30, 2014, the aggregate carrying amount of the Private Education Loans included under the Private education loan line items on our Condensed Consolidated Balance Sheet was $94,611. The outstanding principal balance of the Private Education Loans, including accrued interest, was approximately $226,931 as of September 30, 2014.

*Initial Measurement*. A significant number of the Private Education Loans were determined to be credit impaired upon consolidation. Loans determined to be credit impaired upon consolidation or acquisition ( Purchased Credit Impaired Loans or PCI Loans ), are initially measured at fair value in accordance with ASC 310-30, Receivables Loans and Debt Securities Acquired with Deteriorated Credit Quality ( ASC 310-30 ). A loan is considered a PCI Loan if it has evidence of deteriorated credit quality following the loan s origination date. As a result, at the date of consolidation or acquisition, it is probable that all contractually required payments under a PCI Loan will not be collected.

The Private Education Loans that did not individually have evidence of deteriorated credit quality at the time of consolidation were also initially measured at fair value and are accounted for in accordance with ASC 310-30. We believe that following the guidance of ASC 310-30 by analogy with respect to those loans provides the most reasonable presentation of the value of those loans, primarily due to:

- the evidence of deteriorated credit quality of a significant number of the Private Education Loans; and

- the probability that all contractually required payments with respect to those loans will not be collected.

All of the Private Education Loans are, therefore, considered to be, and reported as, PCI Loans.

This accounting treatment is consistent with the American Institute of Certified Public Accountants (the AICPA ) December 18, 2009 confirmation letter (the Confirmation Letter ), in which the AICPA summarized the SEC staff s view regarding the accounting in subsequent periods for discount accretion associated with loan receivables acquired in a business combination or asset purchase. In this letter, the AICPA states that it understands that the SEC staff will not object to an accounting policy based on contractual or expected cash flow. We believe that following ASC 310-30 by analogy with respect to the Private Education Loans that did not individually have evidence of deteriorated credit quality at the time of consolidation is an appropriate application of the accounting guidance to determine the initial measurement of the value of those loans.

*Aggregation of Loans*. PCI Loans recognized upon consolidation or acquisition in the same fiscal quarter may be aggregated into one or more pools, provided that the PCI Loans in each pool have common risk characteristics. The Private Education Loans were considered to be PCI Loans upon consolidation. As of the date of the PEAKS Consolidation or the 2009 Entity Consolidation, as applicable, we aggregated the PEAKS Trust Student Loans into 24 separate pools of loans and the 2009 Entity Student Loans into 48 separate pools of loans, based on common risk characteristics of the loans, which included:

- the fiscal quarter in which the Private Education Loan was purchased by the PEAKS Trust or the 2009 Entity; and

- the consumer credit score of the borrower.

Table of Contents

PCI Loans that do not have evidence of deteriorated credit quality are not aggregated in the same pools with PCI Loans that have evidence of deteriorated credit quality. The same aggregation criteria, however, were used to determine those loan pools. Each loan pool is accounted for as a single asset with a single composite interest rate and an aggregate expectation of cash flows.

*Estimated Fair Value, Accretable Yield and Expected Cash Flows*. The Private Education Loans were recorded at their estimated fair value upon consolidation. The estimated fair value of the PEAKS Trust Student Loans as of February 28, 2013 and the 2009 Entity Student Loans as of September 30, 2014 was determined using an expected cash flow methodology. Projected default rates and forbearances were considered in applying the estimated cash flow methodology. Prepayments of loans were not considered when estimating the expected cash flows, because, historically, few Private Education Loans have been prepaid. No allowance for loan loss was established as of the date of consolidation of the PEAKS Trust and the 2009 Entity, because all of the Private Education Loans were recorded at fair value and future credit losses are considered in the estimate of fair value.

The excess of any cash flows expected to be collected with respect to a loan pool of the Private Education Loans over the carrying value of the loan pool is referred to as the accretable yield. The accretable yield is not reported on our Condensed Consolidated Balance Sheet, but it is accreted and included as interest income using the effective interest method, which is at a level rate of return over the remaining estimated life of the loan pool.

The following table sets forth the estimated fair value, accretable yield and expected cash flows for the PEAKS Trust Student Loans and 2009 Entity Student Loans, in total and for those loans pursuant to which ASC 310-30 was applied by analogy, as of the dates indicated:

| | PEAKS Trust Student Loans As of February 28, 2013 | | 2009 Entity Student Loans As of September 30, 2014 | |
|---|---|---|---|---|
| | Total | ASC 310-30 Applied By Analogy | Total | ASC 310-30 Applied By Analogy |
| Estimated fair value | $ 112,116 | $ 60,177 | $ 27,199 | $ 12,799 |
| Accretable yield | 100,953 | 58,843 | 12,498 | 5,651 |
| Expected cash flows | $ 213,069 | $ 119,020 | $ 39,697 | $ 18,450 |

The following tables set forth information regarding aggregate changes in accretable yield of the loan pools of the PEAKS Trust Student Loans, in total, and for those loans pursuant to which ASC 310-30 was applied by analogy, for the periods indicated:

| | Three Months Ended September 30, 2014 | | Three Months Ended September 30, 2013 | |
|---|---|---|---|---|
| | Total | ASC 310-30 Applied By | Total | ASC 310-30 Applied By |

| | | | | |
|---|---|---|---|---|
| | | Analogy | | Analogy |
| Balance at beginning of period | $ 59,929 | $ 36,444 | $ 99,475 | $ 60,533 |
| Accretion | (2,727) | (1,602) | (4,072) | (2,334) |
| Reclassification from nonaccretable difference and changes in expected cash flows | (2,077) | (830) | (16,513) | (11,451) |
| Balance at end of period | $ 55,125 | $ 34,012 | $ 78,890 | $ 46,748 |

| | Nine Months Ended September 30, 2014 | | Nine Months Ended September 30, 2013 | |
|---|---|---|---|---|
| | Total | ASC 310-30 Applied By Analogy | Total | ASC 310-30 Applied By Analogy |
| Balance at beginning of period | $ 70,580 | $ 42,274 | $ 0 | $ 0 |
| Additions resulting from the PEAKS Consolidation | | | | |