Lead Plaintiff, Thomas Schroder ("Lead Plaintiff"), individually and on behalf of all other persons similarly situated, by his undersigned attorneys, alleges the following based upon personal knowledge as to himself, and information and belief as to all other matters based upon, inter alia, the investigation of Lead Plaintiff's counsel, which included a review of United States Securities and Exchange Commission ("SEC") filings by Career Education Corp. ("CEC" or the "Company"), as well as securities analysts' reports about the Company, press releases, media reports and other public statements issued by the Company and interviews with witnesses, including former employees of the Company.

Nature Of The Action And Summary Of Allegations

1. This is a federal class action on behalf of persons who purchased the securities of CEC between January 28, 2003 and December 2, 2003, inclusive (the "Class Period"), who have suffered damages thereby, seeking to pursue remedies under the Securities Exchange Act of 1934 (the "Exchange Act").
2. CEC is a provider of private, for-profit post-secondary education, with 78 campuses throughout the United States, Canada, France, the United Kingdom and the United Arab Emirates. CEC owns and operates schools in the following career-related fields: Visual Communication and Design Technologies, Information Technology, Business Studies, Culinary Arts, and Health Education.

3. The Company’s business is highly regulated by federal, state and private accrediting agencies, including the Accrediting Council for Independent Colleges and Schools ("ACICS"). The Company’s business and stock price is dependent upon maintaining compliance with federal and state rules, and on maintaining its accreditation and reputation with students and employers.

4. Throughout the Class Period, the Company publicly touted its business and financial performance, the performance of its stock price and its industry leading position as reasons why investors should purchase its stock. For example, on a webpage titled “Why Invest in CEC?”, the Company represented that it has “demonstrated operational excellence,” enjoys a “strong competitive advantage,” is “a growth leader in a growth market,” and has “a graduate placement record that consistently ranks among the industry leaders.” Similar representations touting CEC’s business and growth were included in the Company’s press releases, SEC filings and conference calls. Such representations were materially false and misleading because, unbeknownst to investors, defendants failed to disclose that CEC had been regularly falsifying student records in order to increase graduation rates and enrollment, and conceal problems that could have threatened the accreditation of its schools. Among other things, CEC’s schools conferred degrees upon students who had not completed required courses and regularly credited and billed students for taking courses the students had never attended. Because many of CEC’s
students receive federal financial aid, the federal government paid tuition bills for courses not attended or passed by students. CEC improperly recognized and reported such payments as revenue. In addition, CEC improperly calculated its Bad Debt Reserve to cover up the problems associated with the improper recognition of revenue. The strong growth reported by the Company throughout the Class Period was grounded in these fraudulent and inherently unsustainable practices, rendering CEC’s reported historical financial performance and projections of future growth materially false and misleading.

5. Defendants were motivated to engage in the fraud alleged herein, in part, so that the Individual Defendants could sell their personally-held CEC stock at artificially inflated prices. During the Class Period, defendant Larson reaped proceeds of $22.4 million and defendant Pesch $11.2 million from the sale of CEC stock.

6. In addition, defendants were further motivated to artificially inflate the Company’s results and stock price so that CEC could complete the strategic acquisition of Whitman Education Group, Inc. using CEC stock as currency. The fraud allowed the Company to execute the acquisition on more favorable terms than if the truth about the Company’s business practices had been known. On July 1, 2003, CEC announced that it had completed the acquisition of Whitman Education Group, Inc. in a combination cash and share exchange transaction valued at $245 million.

7. On November 11, 2003, the Bergen Record, a local New Jersey newspaper, reported that a former director of CEC’s Gibbs College in New Jersey had alleged that the school routinely graduated students who did not complete required courses or attend mandatory internships. These allegations were made in a wrongful termination action filed by a former Director of Career Services of Gibbs College Montclair in the Superior Court of New Jersey on
November 5, 2003. The former director alleges that she was terminated after repeatedly complaining to her supervisors about the fraudulent business practices she regularly witnessed at the school. The fraudulent practices included the falsification of academic records in colleges operated by CEC in order to continue to receive State of New Jersey and federal funding; and the conferring of degrees upon students who did not complete required courses of study, and in some cases, who did not attend classes. Because the story appeared in a local New Jersey daily with very limited circulation, it was not digested by the market and did not immediately affect the Company’s stock price.

8. On November 17, 2003, the Company issued a press release announcing the filing of the wrongful termination action. In a press release, the Company denied the allegations, stating that “[t]he company believes the lawsuit is without merit and intends to vigorously defend itself.” The Company’s stock price plummeted on the news, falling from $52.70 per share on November 14, 2003 to $42.56 per share on November 17 (the next trading day), a one-day drop of 19.2%. Nonetheless, CEC’s stock price rebounded over the next few weeks as the market shrugged off the allegations in the lawsuit as isolated and unlikely to have a materially negative impact the Company’s overall operations, absorbing the Company’s representations regarding the matter.

9. However, on December 3, 2003, the market learned that similar accusations of wrongdoing had been leveled by a highly-placed employee of a different CEC school in California. On December 3, 2003, Bloomberg News reported that the former registrar of CEC’s Brooks Institute of Photography in Santa Barbara, California filed a complaint with ACICS alleging that the school falsified student records to ensure that the school passed inspections by accreditation auditors and to increase enrollment. Bloomberg News quoted the
former registrar as alleging that "Many staff members have been asked by management to commit forgery, fraud, perjury or whatever is necessary to pass audit inspections." (Emphasis added). On December 4, 2003, The Street.com quoted the former registrar as stating that "officials at the school acted illegally and improperly to inflate enrollment and boost the bottom line." (Emphasis added).

10. In reaction to this latest revelation, CEC's stock price plummeted again, falling from $54.76 per share on December 2, 2003 to $39.48 on December 3, 2003, a one-day drop of 28%, on trading volume of 18.2 million shares -- more than nine times the Company's three month daily average.

JURISDICTION AND VENUE

11. The claims asserted herein arise under and pursuant Sections 10(b) and 20(a) of the Exchange Act [15 U.S.C. §§ 78j(b) and 78t(a)] and Rule 10b-5 promulgated thereunder by the SEC [17 C.F.R. § 240.10b-5].

12. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. §1331 and §1337, and Section 27 of the Exchange Act.

13. Venue is proper in this District pursuant to Section 27 of the Exchange Act and 28 U.S.C. §1391(b). Many of the acts charged herein, including the preparation and dissemination of materially false and misleading information, occurred in substantial part in this District and CEC maintains its headquarters in this District.

14. In connection with the acts alleged in this complaint, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the mails, interstate telephone communications and the facilities of the national securities markets.
PARTIES

15. Lead Plaintiff, as set forth in the accompanying Certification, incorporated by reference herein, purchased the common stock of CEC at artificially inflated prices during the Class Period and has been damaged thereby.

16. Defendant CEC is a corporation organized under the laws of Delaware with its principal executive offices located at 2895 Greenspoint Parkway, Suite 600, Hoffman Estates, IL 60195.

17. Defendant John M. Larson ("Larson") was CEC’s Chief Executive Officer, President and Chairman of the Board throughout the Class Period. Larson has served in these capacities since CEC’s inception in 1994. Larson received a salary and bonus in 2003 of $750,000 and $762,500, respectively; in 2002, a salary and bonus of $600,000 and $1,043,550; and in 2001, a salary and bonus of $450,000 and $537,500, respectively. The bonus component of Larson’s annual compensation is based upon annual quantitative and qualitative performance targets established by the Board of Directors. From 1989 until 1993, Larson served as the Senior Vice President of College Operations of Phillips Colleges, Inc., ("Phillips") a nationwide system of 58 schools. During the period of his tenure at Phillips, the institution was repeatedly cited in Student Financial Assistance Proceedings for failure to provide documentation to support the award of government financial aid. In In the Matter of Phillips Colleges, Inc., Dkt. No. 93-39-SP, following an audit of Phillips’ operations for the period July 1, 1987 - December 31, 1991, the judge determined that Phillips did not possess the required backup material and underlying information to support its request for federal funds and ordered Phillips to repay $110,356. The judge noted, “As a starting point it is abundantly clear that Phillips’ records were so deficient and filled with gaps that they could not be used to verify the fair-share amounts at issue.” Similarly, in In the Matter of Phillips Colleges, Inc., Dkt. No. 94-4-SP, this same court determined that
Phillips received a total of $242,962 in fair-share awards for the 1990-91 and 1991-92 award years, but did not provide documentation to prove it was entitled to receive those funds. In this decision, the court noted, "... Phillips was clearly instructed to submit back up documentations ... Phillips has had more than two years to provide the requested reconstruction to support its applications but has consistently refused to do so."

18. Defendant Patrick K. Pesch ("Pesch") was CEC’s Chief Financial Officer, Treasurer and Secretary throughout the Class Period. Pesch has been a director of CEC since 1995. He was an audit manager with Arthur Young & Company, and thus has extensive accounting and auditing experience. Pesch received a salary and bonus in 2003 of $360,000 and $366,000 respectively; a salary and bonus of $300,000 and $360,000 in 2002, respectively; and a salary and bonus in 2001 of $245,000 and $207,000, respectively. Like Larson, the bonus component of Pesch’s annual compensation is directly tied to achievement of specified goals by CEC and are a function of the criteria the Compensation Committee takes into account for the specified areas of responsibility of his office.

19. Defendants Larson and Pesch are referred to herein as the “Individual Defendants.”

20. During the Class Period, the Individual Defendants, as senior executive officers and/or directors of CEC were privy to confidential and proprietary information concerning CEC, its operations, finances, financial condition, present and future business prospects. The Individual Defendants also had access to material adverse non-public information concerning CEC, as discussed in detail below. Because of their positions with CEC, the Individual Defendants had access to non-public information about its business, finances, operations, markets and present and future business prospects via access to internal corporate
documents, conversations and connections with other corporate officers and employees, attendance at management and board of directors meetings and committees thereof and via reports and other information provided to them in connection therewith.

21. In fact, according to a former Controller/Finance Vice President during a portion of the Class Period for one of the Gibbs School in the mid-Atlantic region ("Witness 1"), the information systems at CEC corporate headquarters had the access and ability to "drill down" to the student level in terms of having direct and immediate access to critical financial information, and in fact, CEC corporate could do the close for a particular school without the assistance of the Controller for that particular school. Moreover, CEC held weekly conference calls with the schools, which included certain members from CEC corporate headquarters, including defendant Pesch, wherein critical issues such as student retention rates and collections activities would be discussed. CEC also held periodic "cash collection calls" which Pesch periodically participated in, wherein specific collection efforts related to individual students were discussed, according to a former Finance Manager employed during a portion of the Class Period at one of the CEC schools in the Northeast ("Witness 2") who participated in these calls.

Because of their possession of such information, the Individual Defendants knew or recklessly disregarded the fact that adverse facts specified herein had not been disclosed to, and were being concealed from, the investing public.

22. The Individual Defendants are liable as direct participants in the wrongs complained of herein. In addition, the Individual Defendants, by reason of their status as senior executive officers and/or directors were "controlling persons" within the meaning of Section 20 of the Exchange Act and had the power and influence to cause the Company to engage in the
unlawful conduct complained of herein. Because of their positions of control, the Individual Defendants were able to and did, directly or indirectly, control the conduct of CEC’s business.

23. The Individual Defendants, because of their positions with the Company, controlled and/or possessed the authority to control the contents of its reports, press releases and presentations to securities analysts and through them, to the investing public. The Individual Defendants were provided with copies of the Company’s reports and press releases alleged herein to be misleading, prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. Thus, the Individual Defendants had the opportunity to commit the fraudulent acts alleged herein.

24. As senior executive officers and/or directors and as controlling persons of a publicly-traded company whose stock was, and is, registered with the SEC pursuant to the Exchange Act, and was traded on the Nasdaq National Market (“Nasdaq”) and governed by the federal securities laws, the Individual Defendants had a duty to promptly disseminate accurate and truthful information with respect to CEC’s financial condition and performance, growth, operations, financial statements, business, markets, management, earnings and present and future business prospects, to correct any previously issued statements that had become materially misleading or untrue, so that the market price of CEC’s securities would be based upon truthful and accurate information. The Individual Defendants’ misrepresentations and omissions during the Class Period violated these specific requirements and obligations.

25. The Individual Defendants are liable as participants in a fraudulent scheme and course of conduct that operated as a fraud or deceit on purchasers of CEC’s securities by disseminating materially false and misleading statements and/or concealing materially adverse facts. The scheme deceived the investing public regarding CEC’s business, operations and
management and the intrinsic value of CEC’s securities, and caused Lead Plaintiff and members of the Class to purchase CEC’s securities at artificially inflated prices.

**LEAD PLAINTIFF’S CLASS ACTION ALLEGATIONS**

26. Lead Plaintiff brings this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of a Class, consisting of all those persons or entities who purchased the securities of CEC between January 28, 2003 and December 2, 2003, inclusive, and who were damaged thereby. Excluded from the Class are Defendants, the officers and/or directors of the Company, members of their immediate families and their legal representatives, heirs, successors or assigns and any entity in which Defendants have or had a controlling interest.

27. The members of the Class are so numerous that joinder of all members is impracticable. Throughout the Class Period, there were approximately 100 million shares of CEC common stock actively traded on the Nasdaq (after the Company’s stock split 2:1 on August 25, 2003). While the exact number of Class members is unknown to Lead Plaintiff at this time and can only be ascertained through appropriate discovery, Lead Plaintiff believes that there are, at the least, hundreds of members in the proposed Class. Record owners and other members of the Class may be identified from records maintained by CEC or its transfer agent and may be notified of the pendency of this action by mail, using the form of notice similar to that customarily used in securities class actions.

28. Lead Plaintiff’s claims are typical of the claims of the members of the Class as all members of the Class are similarly affected by Defendants’ wrongful conduct in violation of federal law that is complained of herein.
29. Lead Plaintiff will fairly and adequately protect the interests of the members of the Class and has retained counsel competent and experienced in class and securities litigation.

30. Common questions of law and fact exist as to all members of the Class and predominate over any questions solely affecting individual members of the Class. Among the questions of law and fact common to the Class are: i) whether the federal securities laws were violated by Defendants' acts as alleged herein; ii) whether statements made by Defendants to the investing public during the Class Period misrepresented material facts about the business and operations of CEC; and iii) to what extent the members of the Class have sustained damages and the proper measure of damages.

31. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. Furthermore, as the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it impossible for members of the Class to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

SUBSTANTIVE ALLEGATIONS

The Nature of the Wrongdoing

Falsifying Student Information

32. Lead Plaintiff, through undersigned counsel, has interviewed more than a dozen former CEC employees at CEC schools located throughout the United States. The reports of wrongdoing at various CEC schools by these witnesses are remarkably consistent, and
constitute further strong evidence that this wrongdoing is pervasive throughout CEC institutions and is known to and encouraged by CEC corporate, including the Individual Defendants.

33. CEC, according to more than a dozen former employees, engaged in a pervasive practice and pattern which consisted of (a) falsifying student records in order to obtain financial aid monies and portray CEC schools as having increasing attendance and revenue to garner the favor of the investing public and (b) manipulating CEC schools’ financial statements in order to artificially inflate revenue, lower bad debt reserves, and to avoid cessation of funding from financial aid sources.

34. According to a wrongful termination suit filed in the Superior Court of New Jersey, Bergen County, entitled Twana Rose v. Gibbs College Montclair, et al., Dkt. No. BER-L-8033-03, plaintiff, the former Director of Gibbs’ Career Services Department, alleged that Gibbs falsified records to continue to receive state and federal funding. In addition, plaintiff therein alleged that a number of students who did not complete, or even attend, required courses of study were allowed to graduate.

35. These allegations apply throughout CEC. That is confirmed by former employees of various CEC schools. Unanimously, each witness indicated that CEC corporate set unrealistic performance objectives for new students and advised the schools, “I don’t care how you do it, just get it done,” as relayed by a former Director of Tuition Planning and Admissions employed during the early part of the Class Period at one of CEC’s culinary schools in the Northeast (“Witness 3”). Similarly, Witness 1, like Witness 3, was told to “go and find” the money necessary to meet the unrealistic growth goals imposed by CEC, which Witness 1 said could only be done by deviating from generally accepted accounting principles (“GAAP”) which
she was directed to do by her superiors. Such GAAP deviations included using certain accrual 
accounts as “slush funds” in order to understate various expenses incurred in the period.

36. Witness 1 indicated that one school prepared a 2003 budget which showed 
an expected 7% EBITDA profit, after posting a 12% EBITDA loss in the prior year. The budget 
was presented to the Individual Defendants and the CEC Board of Directors. However, the 
budget was rejected and Witness 1 was told to prepare a budget with much higher growth and 
EBITDA projections. Ultimately, the final budget called for an 18% EBITDA profit, which 
Witness 1 indicated was not achievable without violating GAAP or otherwise committing fraud.

37. CEC had two critical metrics for measuring its success, according to 
Witness 1. The first was in terms of overall enrollments - the number of students that pay an 
application fee ($50-200 depending on the school). The second metric is the number of “starts” 
(i.e., the number of students who actually show up for classes on the first day and remain in 
school until the “Add/Drop” date), which should be about five days from the first day of class. 
Once the Add/Drop date is past, if a student drops out, it is considered an “education problem” as 
 opposed to an admissions shortcoming (and therefore is not included in the Company’s claims 
for the period regarding the number of starts). There was considerable flexibility at CEC schools 
when the Add/Drop date was actually enforced, according to Witnesses 1 and 2. For example, if 
starts for a certain period were below goal, the “Add/Drop” date would be pushed out by one or 
two weeks so that additional students could be added, (but no dropped students counted) despite 
the fact that these students would have missed the first two weeks of school.

38. In addition, numerous former CEC employees, including Witnesses 1, 2 
and 3, each employed at different CEC institutions, admitted that although students entering 
CEC schools were supposed to have complete “packages” of financial aid and loans at the time
of enrollment (referred to as “fully packaged”), in many cases, this was not true. According to a former Director of Financial Aid employed during part of the Class Period at one of the CEC schools in the Southeast ("Witness 4"), at the start of a given quarter only about 70% of all new students could be considered “fully packaged”. Witness 4 indicated the financial aid staff would attempt to package the remaining 30% during the ensuing quarter, but if unsuccessful, the student would be withdrawn. Thus, it was very common for a student to start school with only a portion of their aid and loans in place, with no certainty of how the remainder of the funding would be provided. This was significant for several reasons. First, it was counted as a “start” for purposes of student enrollment, a number emphasized by CEC in its financial press releases and filings, even though there was no certainty where funding for the remainder of the tuition would be derived. Witness 4 indicated that the quarter in which July 2003 fell, 273 students “started” at his school, but only 35 were fully packaged. In fact, many of these students ended up dropping out. However, CEC corporate received accurate student status reports from the schools, according to Witness 2, and thus knew that most of the “starts” were not fully packaged and many would ultimately drop out.

39. Witness 2 indicated that 4-6% of the students in a given period should not have been counted as active students, as they were not actually attending classes. Witness 2 went upon occasion to find “enrolled” students and would be told by the teacher that the student had never shown up, but nonetheless was being counted as an active student.

40. As with any for-profit job placement agency, CEC would collect a portion of the student’s income for job placement. This was then reported as revenue for the school. A former Director of Career Services employed at a CEC school in the Northeast ("Witness 5") further confirmed that CEC corporate exerted “tremendous pressure” at the school level to
achieve certain performance goals that were essentially unattainable. Witness 5 indicated that when actual performance failed to meet goals, CEC reported revenues associated with student placements that had not actually occurred, which inflated revenue. When eventually this artificial revenue could not be collected because the placement never occurred, the account was then treated as a "bad debt."

41. According to a former Employer Relations Manager employed during part of the Class Period by CEC corporate who was responsible for attempting to obtain employment for graduating students at one of CEC’s online university programs ("Witness 6"), CEC touted a 98% placement rate for graduating students, which percentage was, in fact, based upon certain "loopholes." For example, if a student had been in military service while participating in the online program, CEC would consider the graduating student’s ongoing military service following graduation as a job placement. Similarly, if a graduate enrolled in a new CEC program, this was also counted by CEC as a job placement. Moreover, if a student procured a job on his or her own behalf, CEC counted it as a placement even if the school did not interact with the employer on the student’s behalf. This practice was confirmed by Witness 2.

42. In addition, according to Witness 2, it was a "CEC invention" to provide loans to students who were otherwise unable to obtain sufficient financing from other sources to pay for their complete tuition. For example, if the total cost of tuition was $30,000, and the student only obtained $13,000 in financial aid, CEC would arrange for the student to pay $100 per month throughout the student’s attendance at school. Presuming no other sources of financing were available, CEC would make a loan to cover the remaining tuition costs. However, the loan money was never placed into the student’s hands but was simply applied to the student’s accounts to pay the tuition. Witness 2 indicated that CEC would recognize revenue
throughout the term of the student’s enrollment even when the tuition was being paid from a loan extended by CEC. Witness 2 referred to this as “make believe money” because CEC was essentially recognizing revenue (and a receivable) based on monies it had lent to its students.

43. Witness 2 also indicated that she had been asked to falsify student records. On numerous occasions when students dropped out of school, the school would not notify the government agency so that the school would continue to receive government reimbursement.

44. In addition, Witness 2 confirmed that the school would falsify student records to show as still enrolled a student who had dropped out, but whose financial aid applications had not been completed prior to the student dropping out. CEC did this in order to obtain the financial aid to cover the student’s tuition. Although a school is eligible to receive government money for a student who drops out and for which tuition is owed, it is improper to falsify records to create the appearance that the student was still enrolled.

45. According to a former Director of Admissions at one of the CEC schools who was employed for 9 years by CEC at a school in the Northeast ("Witness 7"), he was ordered by the school comptroller to falsify student entrance exams in order to build student population.

46. Similarly, Witness 1 was personally aware of the school being unable to locate records of students who had purportedly graduated, so the school’s Director of Placement simply typed up phony records in order to satisfy the compliance auditors. According to Witness 4, the auditing firm that performed accreditation reviews and audits for CEC and reported back to the Department of Education was Almich & Associates ("Almich"). CEC had every opportunity to falsify the records, as Almich would provide the schools with approximately a week’s prior notice of the specific records they wanted to review.
47. According to a former Admissions Representative employed prior to and throughout the Class Period by a CEC school in the Midwest ("Witness 8"), CEC counted as starts students who were not fully packaged and subsequently dropped out of school without ever becoming fully packaged. However, the school continued to receive government monies for these students who had dropped out and the school held onto that money for months, still counting these students as active students. Witness 8 stated that the school held onto the government money for as long as six months to combat the reality (i.e., monthly start goals were declining). Thus, during 2003, the school continued counting dropped out students as current, and kept monies received. This enabled the school to obtain an "A-Team" designation for 2003.

48. Similarly, Witness 2 indicated that her school kept government monies for up to two terms (approximately six months) before returning it for students who dropped out; it was Witness 2's understanding that CEC did this "for the stock" so CEC could report more students being enrolled than was actually the case.

49. In 2004, according to Witness 8, the school began the process of returning the government money, in advance of a major accreditation audit, and believed there were approximately 50 student files, each representing as much as $2,000 to $3,000 per student that had to be refunded.

50. One witness, a former Regional Director of Admissions based at corporate headquarters in Hoffman Estates ("Witness 9"), indicated that if a school failed to meet performance goals, defendants Larson and Pesch would closely question school officials why goals had not been met.
51. Witness 9 indicated that Larson and Pesch both received accurate “non-scrubbed” data about the financial and packaging of each and every enrolled and prospective student, as well as “scrubbed” (i.e. inaccurate) data about the same students.

52. Witness 9 also participated in making a brief presentation at a shareholder meeting. Witness 9 knew at the time that the information pertaining to the number of students enrolled, admitted and currently attending classes in Witness 9’s division was not correct, because she was aware that certain students were being counted as current when, in fact, they had dropped out. Thus, Witness 9 tempered the information by prefacing it with words to the effect “this is the best information I have right now, but it is not the most up-to-date information.” Following the meeting, Witness 9 was told that defendant Larson was furious that she had not been “more affirmative” in reporting the numbers, and that Witness 9 would no longer be allowed to report results.

53. According to Witness 9, CEC overstated the cumulative number of “starts” for any given period across the board by 10-20%, with the larger CEC schools particularly overstated; for instance, in order to report as many “starts” as possible, CEC would continue to admit students even though the students would have missed 20-25% of the quarter’s classes, over the objection of the teachers.

54. According to a former Student Services representative at a CEC school in the Midwest (“Witness 10”), there was a push in 2003 to increase starts to meet objectives. Thus, certain “special needs” students were admitted, including one individual who was completely illiterate, one who performed at a 7th grade level and another at a 4th grade level. Various poor quality students were admitted in 2003, including felons, homeless persons and drug addicts, and the school tolerated delinquent payments.
55. Witness 10 indicated that at the end of 2003, the student body count was
officially about 775 students, but Witness 10 states that the number of students who actually
were active and attending classes was closer to 650 students. Witness 10 had personal
knowledge of this fact, as she was given the project of ensuring that each student's file contained
all necessary documentation to be in compliance, such as transcripts and diplomas. Based upon
her first-hand knowledge of this task, Witness 10 indicated that at least 25% of the 775 files were
missing critical documents. Witness 10 sought to locate the students to obtain the missing
paperwork; many students could not be found. In fact, several students who were on attendance
rolls, when contacted at home, maintained that they had not been attending classes.

56. According to a former Director of Career Services employed during the
Class Period at a CEC school in California ("Witness 11"), in order to claim "credit" for
placement services, the President of the school directed his executive assistant to call graduated
students in or about September, 2003 and offer them $50 plus a shirt if the graduate students
provided information on their employment so that the school could claim credit for the
"placement," despite the fact that the school had provided absolutely no services for such
placement. According to Witness 10, the placement rate increased from 69% to 85%. After
Witness 11 brought certain issues to the corporate headquarter, she was placed on probation and
eventually terminated.

Defendants' Improper Accounting Practices

57. Witnesses 1, 2 and 3 indicated that CEC's practice of admitting students
who were not fully packaged (i.e., had insufficient aid and loans to cover tuition costs) was
improper. According to Witness 2, at one school, approximately 200 to 250 new students would
be admitted each quarter. Of these 200 to 250 new students, typically 30-40% (60-90
individuals) would not be fully packaged. Of these 60-90 individuals, approximately 20% would
receive loans from CEC. The remaining 80% (48-72 individuals) would have received enough modest financial aid that the school would permit them to attend classes, with no certainty how the remaining tuition would be paid. Not surprisingly, most eventually dropped out, but did so owing additional tuition money.

58. According to Witnesses 1, 2, 3 and 4, all past due accounts in which payment had not been received within 90 days were sent to a third-party collection agency. However, if even a single penny was paid during a 90-day window, then the account was considered “current” and would not be sent to collections. Witness 1 also explained that CEC took a great deal of latitude with the method of calculating its bad debt for aging accounts receivable (i.e. monies owed by the students). For example, if a student owed $10,000 to CEC, but the student paid $1 in a given quarter, only 10% of the total amount due was included in the bad debt expense -- even though the student might owe the $10,000 for several quarters; an approach consistent with GAAP would have been to either add 50%-75% of the total amount due to the bad debt expense, or write off the amount altogether as uncollectible, as collection was extremely unlikely.

59. A former CEC Vice President of Finance employed at the start of the Class Period at a CEC school in the Mid-Atlantic region, (“Witness 12”) stated that CEC’s practice of setting up payment plans to cover unpackaged tuition costs was a “bomb waiting to go off”, because many of the students would drop out, owing money to CEC. This led to a significant problem with Bad Debt. At the end of 2002, according to Witness 12, his school reported approximately $30 million in revenue and expensed 10% of that as Bad Debt for 2002. Witness 12 stated that the $3 million reported for Bad Debt was a significant understatement because if a student made a minimal payment, it was counted as a current account.
60. Witness 12 said that in December 2002, the school hired four people to contact “nonstop” students who had dropped out to collect minimal one-time payments of $40 or $50 per person so the accounts could be considered “current”. However, there was no attempt to establish set payment plans with these former students.

61. According to Witness 2, this method of calculating the Bad Debt Reserve using such miniscule partial payments was set forth in a spreadsheet disseminated from CEC corporate, and located and maintained at CEC corporate. Witness 12 also confirmed that CEC utilized a “template” to calculate Bad Debt Reserves. The spreadsheet required a user to fill in fields regarding the payments made on specific student accounts. Thus, personnel at CEC’s headquarters, including Pesch and Larson, knew on a daily basis exactly how much had been paid, down to the individual student at each school. As such, it would be clear to anyone looking at the spreadsheet that many students were making miniscule partial payments and had very large outstanding balances, the reported Bad Debt Reserve for a given school notwithstanding.

62. According to a former Finance Manager employed during the Class Period at a CEC school in the Northeast ("Witness 13") his school held weekly conference calls with corporate headquarters in which both Larson and Pesch periodically participated, wherein admissions, financial aid packaging for new students, collections on student accounts and other items were discussed. During these conference calls, the corporate personnel would tell school officials to “do whatever it takes” to meet goals.

63. Witness 13 also confirmed that Bad Debt Expense was critically understated, due to the practice of collecting minimal partial payments from delinquent students, sometimes as little as $1 or $2, in order to consider the account “current.” For example, one student was given a 100 year payment plan at $5 per month in order to pay off her account.
64. Witness 13 further indicated that in the first quarter of 2003, the school reported about $12 million in total Accounts Receivable. Witness 13 stated that the reported Bad Debt Expense for the first quarter of 2003 was approximately $50,000 - $60,000, which he maintained was a “skewed number” because many of the accounts shown as current were never going to be collected. In his opinion, the Bad Debt Expense should have been at least 10 times greater – at least $500,000 or higher. Witness 13 advised his superiors that there were issues involving the collectibility of money owed by students, and further advised them that at the rate things were going, the school’s actual Bad Debt Expense would be $1.5 million to $2 million by the end of 2003.

65. In one incident at the end of 2002, when personnel were attempting to collect on student accounts, Witness 13 saw the President of the school present a “wad of cash” to the collectors and instructed them to apply the money to past-due accounts they had unsuccessfully tried to collect, so the accounts could be counted as current.

66. Witness 13 also said that the school falsely reported students as attending classes in order to receive financial aid/loan money for the students. Witness 13 recalled students who were literally crying as they swore that they had not attended the classes for which they were being billed.

67. In addition, according to Witness 2, CEC corporate received an additional report which set forth reported cash deposits, as posted to specific student accounts, which was used as part of the monthly cash projections to compare projected collections against actual projections during a specific period. Thus, the discrepancies were, or should have been, readily apparent to Pesch and Larson.
68. Witness 2 further stated that if a student account was given to a collection agency, if the student made a partial payment of any kind to the collection agency, the student’s account would be taken back from the collection agency and returned as an active account on the school’s books.

69. According to Witness 2, the Controller of the school told Witness 2 on several occasions that she had been told to “fudge numbers and make up stuff.”

70. Witness 5 indicated that revenue would be reported for student placements that had not actually taken place; when the “revenue” could not be collected, it became “bad debt”.

71. According to Witness 10, the official policy was that if more than 20 days passed from the date of a student’s last recorded attendance, the student was to be dropped. However, in 2003, Student Services representatives were told to call students to “coax” them to sit in classes so that their financial aid money could be collected for the period.

Defendants’ False and Misleading Statements

Fourth Quarter And Year-End 2002

72. On January 28, 2003, the Company announced “record results” for fiscal year 2002, including record net revenues, net income and student population for the fourth quarter and year ended December 31, 2002, purportedly its twentieth consecutive quarter of record results since become a public company. Fourth quarter 2002 net revenues were $219.7 million, up 42 percent from $155.2 million for the same period last year. Fourth quarter 2002 net income was $31.0 million, or $0.65 per diluted share, up 61 percent from the prior year’s fourth quarter net income of $19.3 million, or $0.42 per diluted share. Full year 2002 net revenues were $751.0 million, up 42 percent from $529.2 million a year earlier. Full year 2002 net
income was $67.5 million, or $1.42 per diluted share, up 76 percent from $38.4 million, or $0.85 per diluted share.

73. With respect to student enrollment, the Company stated that January 2003 new student starts rose 28 percent to approximately 10,550, up from approximately 8,250 for the same period last year. Fourth quarter 2002 new students starts rose 18 percent to approximately 13,100, up from approximately 11,100 for the same period last year. Total student population on January 31, 2003 was expected to be approximately 51,100, up 21% from approximately 42,100 on January 31, 2002.

74. In the January 28, 2003 press release, defendants also provided information with respect to CEC’s accounts receivables and bad debt expense:

- Quarterly Days Sales Outstanding (DSOs) for total accounts receivables were 33 days at December 31, 2002. This represents a three-day decrease in the quarterly DSOs at December 31, 2002 of 36 days.

- Bad Debt Expense was 3.7 percent for the quarter ended December 31, 2002, compared with 3.7 percent for the quarter ended December 31, 2001.

75. Commenting on the Company’s “record” results, defendant Larson stated, among other things:

Career Education Corporation had an outstanding 2002, achieving record growth and profitability and becoming the world’s largest on-campus provider of private, for-profit postsecondary education in terms of revenue.

76. The representations set forth above with respect to the January 28, 2003 press release were each materially false and misleading when made because they failed to disclose and misrepresented the following material adverse facts, among others:

(a) during the Class Period, CEC had systematically falsified student records in order to increase start, enrollment and graduation rates, and to conceal problems to
help its schools pass audits conducted by the ACICS and the U.S. Department of Education, among other agencies;

(b) a material portion of the Company's reported revenues were improperly recognized because they were derived through fraudulent business practices, such as federal grants and financial aid payments made based upon records and representations that were falsified by the Company;

(c) the Company's reported results did not accurately represent the Company's financial condition because a material portion of those results were attributable to improper accounting practices;

(d) the Company's accounts receivables and bad debt expense results were attributable to improper accounting practices;

(e) contrary to statements in its press releases, the Company's success was not attributable solely to the supposed strength of its business or its supposed competitive advantages, but rather, a material portion of its results were attributable to fraudulent and prohibited business practices;

(f) the Company failed to disclose that CEC had falsified student records, thereby placing its accreditation at serious risk and jeopardizing the ability of its students to qualify for financial aid, which would have a devastating impact on CEC's business; and

(g) the Company's results were not prepared and reported in accordance with GAAP and did not fairly present its actual financial results or condition.

77. On March 10, 2003, the Company filed its annual report with the SEC on Form 10-K. The Company's Form 10-K was signed by the Individual Defendants, reaffirmed its
previously-announced financial results and enrollment numbers set forth in the January 28, 2003 press release and represented it was prepared in accordance with relevant accounting guidelines. The 10-K was subsequently amended on April 28, 2003 "...in response to comments received from the staff of the SEC in connection with the SEC’s review of [CEC’s] registration statement on Form S-3 filed on March 11, 2003."

78. The 10-K described the financial aid arrangements for students and its regulation in part as follows:

Our schools and students in the U.S. and Canada, as well as U.S. students at our schools in the United Kingdom, participate in a wide variety of government-sponsored financial aid programs (i.e., programs administered by federal, state, provincial, and local government agencies). For this reason, our schools are subject to extensive regulatory requirements imposed by government funding agencies and other bodies. During the 2003 fiscal year, we derived approximately 61% of our revenue on a cash basis from such government-sponsored financial aid received by our students, and we estimate that approximately 73% of our students receive government-sponsored financial aid.

* * *

**Nature of Federal Support for Postsecondary Education in the U.S.** While many states support public colleges and universities primarily through direct state subsidies, the federal government provides a substantial part of its support for postsecondary education in the form of grants and loans to students who can use those funds at any institution that has been certified as eligible by the DOE. These federal programs are authorized by Title IV of the Higher Education Act of 1965, as amended, and are collectively referred to as the “Title IV Programs.”

* * *

**Regulation of Federal Student Financial Aid Programs for U.S. Schools.** To participate in the Title IV Programs, an institution must be authorized to offer its programs of instruction by the relevant agencies of the state in which it is located, accredited by an accrediting agency recognized by the DOE and certified as eligible by the DOE. The DOE will certify an institution to participate in the Title IV Programs only after the institution has demonstrated compliance with the provisions of the Higher Education Act and the DOE’s extensive regulations regarding institutional eligibility. An institution must also demonstrate its compliance with these requirements to the DOE on an ongoing basis. These standards are applied primarily on an institutional basis, with an institution defined as a main campus and its additional branch campus locations, if any.
The substantial amount of federal funds disbursed through the Title IV Programs, the large numbers of students and institutions participating in those programs, and instances of fraud, waste, and abuse by some schools and students in the past have caused the U.S. Congress ("Congress") to require the DOE to increase its level of regulatory oversight. Under the Higher Education Act, accrediting agencies and state licensing agencies also have responsibilities for overseeing institutions, and continued approval by such agencies is necessary for an institution to maintain eligibility to participate in the Title IV Programs. As a result, each of our institutions is subject to detailed oversight and review and must comply with a complex framework of laws and regulations. Because the DOE periodically revises its regulations and changes its interpretation of existing laws and regulations, we cannot predict with certainty how the Title IV Program requirements will be applied in all circumstances.

* * *

An institution's cohort default rate under the FFEL and FDL programs is calculated on an annual basis as the rate at which student borrowers scheduled to begin repayment on their loans in one federal year default on those loans by the end of the next federal fiscal year. An institution whose cohort default rates equal or exceed 25% for three consecutive years will no longer be eligible to participate in the FFEL, FDL, or Pell programs for the remainder of the federal fiscal year in which the DOE determines that such institution has lost its eligibility and for the two subsequent federal fiscal years. An institution whose cohort default rate under the FFEL or FDL program for any federal fiscal year exceeds 40% may have its eligibility to participate in all of the Title IV Programs limited, suspended, or terminated by the DOE.

None of our 34 institutions participating in FFEL or FDL programs had an FFEL or FDL cohort default rate of 25% or greater during any of the last three federal fiscal years.

79. The 10-K also contained a litany of risk factors, including:

Failure to comply with extensive regulations could have a material adverse effect on our business.

Failure of our U.S. schools to comply with extensive regulations could result in financial penalties, restrictions on our operations, or loss of external financial aid funding for our students.

We derive a significant portion of our revenue from students participating in U.S. federal student financial aid programs administered by the DOE. For these programs to be available to its students, a U.S. institution must obtain and maintain authorization by the appropriate state agencies, accreditation by an accrediting agency recognized by the DOE, and certification by the DOE. As a result, our U.S. schools are subject to extensive regulation by these agencies.
These regulations cover virtually all phases of our operations, including our educational programs, facilities, instructional and administrative staff, administrative procedures, marketing and recruiting, financial operations, payment of refunds to students who withdraw, and financial strength. These regulations also affect our ability to acquire or open additional schools, add new educational programs, or change our corporate structure. The agencies that regulate our operations periodically revise their requirements and modify their interpretations of existing requirements.

If one of our schools were to violate any of these regulatory requirements, we could suffer a financial penalty. A regulatory agency could also place limitations on our schools' operations or terminate the schools' ability to grant degrees and certificates or their eligibility to receive federal student financial aid funds on behalf of its students. A significant portion of our students rely on federal student financial aid funds to finance their education. We cannot predict with certainty how all of these requirements will be applied, or whether each of our schools will be able to comply with all of the requirements in the future. We have described some of the most significant regulatory requirements and risks that apply to our U.S. schools in the following paragraphs. Please also see "Business—Financial Aid and Regulation" for more detailed information on the regulations and other requirements that apply to us.

*   *   *

Our schools may lose eligibility to participate in federal student financial aid programs if their student loan default rates are too high, which could harm our student population and revenue.

An institution may lose its eligibility to participate in some or all of the federal student financial aid programs if defaults by its students on their federal student loans exceed specified rates. If any of our institutions, depending on its size, loses eligibility to participate in the federal student financial aid programs because of high student loan default rates, that loss could have a material adverse effect on our student population and revenue.

*   *   *

If students fail to pay their outstanding balances, our business will be harmed.

We offer a variety of payment plans to help students pay that portion of their education expense not covered by financial aid programs. These balances are unsecured and not guaranteed. Losses related to unpaid student balances in excess of the amounts we have reserved for bad debts could have a material adverse effect on our business.

*   *   *
Government and regulatory agencies may conduct compliance reviews, bring claims or initiate litigation against us.

Because we operate in a highly regulated industry, we are subject to compliance reviews, claims of non-compliance or lawsuits by government agencies. If the results of these reviews or proceedings are unfavorable to us or if we are unable to defend successfully against lawsuits or claims, we may be required to pay money damages or be subject to fines, limitations, loss of federal funding, injunctions, or other criminal or civil penalties. Even if we adequately address issues raised by an agency review or successfully defend a lawsuit or claim by the government, we may have to devote significant financial and management resources to address these issues.

80. However, the risk disclosures in the Form 10-K were insufficient and not meaningful because the Form 10-K failed to disclose:

   (a) during the Class Period, CEC had systematically falsified student records in order to increase start, enrollment and graduation rates, and to conceal problems to help its schools pass audits conducted by the ACICS and the U.S. Department of Education, among other agencies;

   (b) a material portion of the Company’s reported revenues were improperly recognized because they were derived through fraudulent business practices, such as federal grants and financial aid payments made based upon records and representations that were falsified by the Company;

   (c) the Company’s reported results did not accurately represent the Company’s financial condition because a material portion of those results were attributable to improper practices; and

   (d) the Company failed to disclose that CEC had falsified student records, thereby placing its accreditation at serious risk and jeopardizing the ability of its students to qualify for financial aid, which would have a devastating impact on CEC’s business.
81. On March 11, 2003, the Company filed with the SEC a registration statement on Form S-3. The shelf registration covered the issuance, from time to time, of up to $300 million of common stock, preferred stock and debt securities. Once declared effective by the SEC, the shelf registration statement would enable the Company to raise funds from the public offering of any individual security covered by the shelf registration statement, as well as any combination of these types of securities, through underwriters, agents, dealers or by sales directly to purchasers, subject to market conditions and the Company's capital needs. The Company's Form S-3 was signed by the Individual Defendants. Therein, the Company incorporated its audited financial results that it filed in its March 10, 2003 Form 10-K.

82. On March 26, 2003, the Company announced that it had entered into a definitive merger agreement with Whitman Education Group, Inc. ("Whitman") under which Career Education would acquire all of the shares of Whitman for a combination of cash and Career Education stock. The transaction would significantly enhance Career Education's position in the rapidly-growth health education field. Under the terms of the agreement, Whitman's shareholders would receive $6.00 in cash and $8.25 in Career Education common stock (for a combined consideration of $14.25) per each share of Whitman stock. The stock portion of the consideration was subject to adjustment based on Career Education's average share price during a specified period prior to closing.

The First Quarter of 2003

83. On April 22, 2003, CEC issued a press release, headlined "Career Education Corporation Posts Record First Quarter Results," marking its "21st consecutive quarter of record results since becoming a public company." The Company summarized its results for the first quarter of 2003 as follows:
First quarter 2003 revenues were $245.6 million, up 39 percent from $176.3 million for the same period last year. First quarter 2003 net income was $19.2 million, or $0.40 per diluted share, up 61 percent and 54 percent, respectively, from first quarter 2002 net income of $12.0 million, or $0.26 per diluted share.

Effective January 1, 2003, bad debt expense is classified as a component of general and administrative expense; previously such expense was classified as a component of net revenue. The change was made to improve comparability of income statement amounts to the Company’s peer group which classify bad debt in this way. If bad debt expense was still classified as a component of net revenue, first quarter 2003 net revenues would have been $236.2 million and the first quarter 2003 increase in net revenues would have remained at 39 percent.

84. In addition, CEC applauded its new starts:

First quarter 2003 new starts rose 38 percent to approximately 14,600, up from approximately 10,550 for the same period last year. The INSEEC Group, that was acquired on February 18, 2003, did not have new student starts during CEC’s period of ownership in the first quarter.

Total CEC student population on April 30, 2003 is expected to be approximately 54,400, up 33 percent from approximately 40,800 on April 30, 2002. On a same school basis, student population is expected to show an increase of approximately 21 percent during these periods.

85. With respect to accounts receivables and bad debt expense, the April 22 press release stated:

- Quarterly Days Sales Outstanding (DSOs) for total accounts receivable were 33 days at March 31, 2003, compared with 33 days at March 31, 2002 and at December 31, 2002.

- Bad debt expense was 3.8 percent as a percent of revenue for the quarter ended March 31, 2003, compared with 3.6 percent for the quarter ended March 31, 2002 and 3.7 percent for the quarter ended December 31, 2002.

86. In the press release, Defendant Larson touted the Company’s results, attributing CEC’s seeming success to the reputation of its schools and track record of finding jobs for students after graduation. In addition, Larson reiterated that the Company signed a definitive merger agreement to acquire Whitman Education Group Inc. earlier in the quarter, stating as follows in relevant part:
“Career Education Corporation had an outstanding first quarter, delivering outstanding organic growth and enhanced operating margins,” said John M. Larson, Chairman, President and Chief Executive Officer. “We also completed a nine-campus acquisition in France with the INSEEC Group and announced a definitive merger agreement with Whitman Education Group, Inc. that will significantly enhance CEC’s platform in health education.”

“Our first quarter 2003 lead flow was up approximately 52 percent over the same period last year proving that our marketing message is effectively reaching an increasing number of high school graduates, young adults, career changers and international students,” Mr. Larson said. “Students come to CEC schools because of the school’s reputation for delivering a high quality education, demonstrated track record in job placement, and exclusive focus on 21st century careers, including visual communication and design, IT, business, culinary arts and health education.”

87. On May 15, 2003, CEC filed its quarterly report on Form 10-Q for the first quarter of 2003 with the SEC (the “1Q03 Report”). The 1Q03 Report reiterated the financial information contained in the April 22, 2003 press release and was signed by defendants Larson and Pesch.

88. In a section of the 1Q03 Report entitled “Basis of Presentation,” the Company represented that the financial information contained therein was prepared in accordance with GAAP and fairly presented the Company’s results, stating as follows in relevant part:

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S- X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included.

89. In the section of the 1Q03 Report titled “Management’s Discussion and Analysis of Financial Condition and Results of Operation,” the Company summarized its quarterly results as follows:
Our revenue increased from $176.3 million during the three months ended March 31, 2002 to $245.5 million for the same period during 2003. In addition, our net income increased from $12.0 million during the first three months of 2002 to $19.2 million during the same period in 2003. For the three months ended March 31, 2003, income from operations increased $11.2 million or 57%, to $30.9 million during 2003 from $19.7 million for the same period during 2002. Income from operations as a percentage of revenue improved from 11.2% during the first three months of 2002 to 12.6% for the same period during 2003.

90. In discussing the risks and uncertainties facing the Company, the IQ03 Report referred readers to “the factors discussed under ‘Management’s Discussion and Analysis of Financial Condition and Results of Operations--Risks Related to Our Business’ in our Annual Report on Form 10-K/A for our fiscal year ended December 31, 2002.” The Form 10-K/A purported to warn investors that the Company is subject to strict regulatory oversight by the U.S. Department of Education, stating in this regard, as follows:

**Failure to Comply with Extensive Regulations Could Have a Material Adverse Effect on our Business**

*Failure of our U.S. schools to comply with extensive regulations could result in financial penalties, restrictions on our operations or loss of external financial aid funding.*

We derive a significant portion of our revenue from U.S. federal student financial aid programs administered by the U.S. Department of Education. To participate in these programs, a U.S. institution must obtain and maintain authorization by the appropriate state agencies, accreditation by an accrediting agency recognized by the Department of Education, and certification by the Department of Education. As a result, our U.S. schools are subject to extensive regulation by these agencies. These regulations cover virtually all phases of our operations, including our educational programs, facilities, instructional and administrative staff, administrative procedures, marketing and recruiting, financial operations, including the payment of refunds to students who withdraw, and financial strength. These regulations also affect our ability to acquire or open additional schools, add new educational programs or change our corporate structure. The agencies that regulate our operations periodically revise their requirements and modify their interpretations of existing requirements. If one of our schools were to violate any of these regulatory requirements, we could suffer a financial penalty. A regulatory agency could also place limitations on our schools’ operations or terminate the schools’ ability to grant degrees and certificates or their eligibility to receive federal student financial aid funds. We cannot predict with certainty how all of these requirements will be applied, or whether each of
our schools will be able to comply with all of the requirements in the future. [Emphasis in original].

91. In the MD&A section of the 1Q03 Report, CEC set forth some of its critical accounting policies:

**Revenue Recognition**

Revenue is derived primarily from programs taught at our schools. Tuition revenue and one-time fees, such as application fees, are recognized on a straight-line basis over the length of the applicable program. Dormitory and cafeteria revenues charged to students are recognized on a straight-line basis over the term of a student’s dormitory and cafeteria use. Other dormitory and cafeteria revenues are recognized upon delivery. Other revenue, such as student laptop computer sales, bookstore sales, placement revenue, restaurant revenue, rental income and contract training revenue, is recognized as services are performed or goods are delivered. The portion of payments received but not earned is recorded as deferred revenue and reflected as a current liability in our consolidated balance sheet, as such amount represents revenue that we expect to earn within the next year. Refunds are calculated and paid in accordance with applicable federal, state and accrediting agency standards and Company policy.

**Allowance for Doubtful Accounts**

Based upon past experience and judgment, we establish an allowance for doubtful accounts with respect to tuition receivables. In establishing our allowance for doubtful accounts, we consider, among other things, a student’s status (in-school or out-of-school), whether or not additional financial aid funding will be collected from Title IV Programs or other sources, whether or not a student is currently making payments, and overall collections history. Changes in trends in any of these areas may impact the allowance for doubtful accounts. The receivable balances of withdrawn students with delinquent obligations are fully reserved in our allowance for doubtful accounts.

Our historical bad debt expense as a percentage of revenue for the three months ended March 31, 2003 and 2002 was 3.8% and 3.6%, respectively.

92. The representations referenced above from the Company’s April 22, 2003 press release and 1Q03 were each materially false and misleading when made because they failed to disclose and misrepresented the following material adverse facts, among others:

(a) during the Class Period, CEC had systematically falsified student records in order to increase graduation and enrollment rates and to conceal problems to help its
schools pass audits conducted by the ACICS and the U.S. Department of Education, among other agencies;

(b) a material portion of the Company’s reported revenues were improperly recognized because they were derived through fraudulent business practices, such as federal grants and financial aid payments made based on records and representations that were falsified by the Company;

(c) the Company’s reported results did not accurately portray the Company’s operations because a material portion of those results were attributable to improper accounting practices;

(d) the Company’s allowance for doubtful accounts and bad debt expense were derived from improper accounting practices;

(e) the Company’s purported risk warnings failed to disclose that the Company had falsified student records and defrauded the federal, state and private agencies which regulate and/or accredit CEC’s schools, thereby placing its accreditation at serious risk and jeopardizing the ability of its students to qualify for financial aid, which would have a devastating impact on CEC’s business; and

(f) that the Company’s results were not prepared and reported in accordance with GAAP and did not fairly present its actual financial results or condition.

The Second Quarter of 2003

93. On July 1, 2003, CEC announced that it had acquired Whitman Education Group, Inc. in a combination cash and share exchange transaction valued at $245 million. Under the terms of the offer, “Whitman’s shareholders will receive $6.00 in cash and 0.138 shares of CEC common stock for each share of Whitman common stock.” The Company’s plan to acquire Whitman Education had been announced prior to the Class Period and was touted as an
important strategic acquisition for CEC. In the July 1, 2003 press release, defendant Larson stated that “[t]his strategic combination will allow us to significantly enhance our position in the rapidly-growing health education field, while further expanding our leadership in information technology and business studies.”

94. On July 22, 2003, CEC issued a press release announcing its 22nd consecutive quarter of “record” results for the second quarter of 2003. The Company also announced a two for one stock split. The Company summarized its performance in the quarter and the first six months of 2003 as follows:

Second quarter 2003 revenues were $256.1 million, up 44 percent from $178.4 million for the same period last year. Second quarter 2003 net income was $19.6 million, or $0.40 per diluted share, nearly double last year’s net income of $10.3 million, or $0.22 per diluted share.

For the six months ended June 30, 2003, revenues were $501.6 million, up 41 percent from $354.7 million for the same period last year. Net income for the first half of 2003 was $38.8 million, or $0.80 per diluted share, up 74 percent from $22.3 million, or $0.47 per diluted share.

95. According to the July 22, 2003 press release:

Second quarter 2003 new student starts rose 46 percent to approximately 12,700, up from approximately 8,700 for the same period last year. The campuses related to the INSEEC and Whitman acquisitions did not contribute to CEC’s second quarter 2003 new student starts.

Total CEC student population on July 31, 2003 is expected to be approximately 63,000, up 55 percent from approximately 40,650 on July 31, 2002. ...On a same school basis, total CEC student population is expected to increase year-over-year by approximately 30 percent.

96. In addition, CEC provided information related to accounts receivable and bad debt expense as follows:

- Quarterly Days Sales Outstanding (DSOs) for total accounts receivable were 33 days at June 30, 2003. This represents a one-day decrease from the quarterly DSOs at June 30, 2002 of 34 days. The company calculates DSOs by dividing its “receivables net” by average daily revenue.
Average daily revenue is computed by dividing quarterly “total revenue” by the total number of days in the quarter.

- Bad Debt Expense was 3.9 percent of total revenue for the quarter ended June 30, 2003, compared with 3.6 percent for the quarter ended June 30, 2002 and 3.8 percent for the quarter ended March 31, 2003.

97. Defendant Larson attributed the reported record results to the “excellent reputation” of CEC’s schools, among other factors, stating as follows in relevant part:

“As the record second quarter and first half results demonstrate, 2003 is another defining year for Career Education Corporation,” said John M. Larson, chairman, president and chief executive officer. “Every element of our multi-pronged growth strategy is working as we continue to deliver enhanced operating results.

“We are achieving high organic growth rates as record numbers of high school graduates and adult students seek high quality career programs at all degree levels,” Mr. Larson said. “CEC schools have excellent reputations in the high-demand career fields of visual communication and design, IT, business, culinary arts and health education. Our broad geographic reach, full range of degree options and targeted marketing programs make our educational programs highly accessible to motivated students looking to succeed in their career field.”

98. On August 13, 2003, the Company filed its quarterly report on Form 10-Q for the second quarter of 2003 with the SEC (the “2Q03 Report”). The 2Q03 Report reiterated the financial information contained in the July 22, 2003 press release and was signed by defendants Larson and Pesch.

99. In a section of the 2Q03 Report titled “Basis of Presentation,” the Company represented that the financial information contained therein was prepared in accordance with GAAP and fairly presented the Company’s results, stating as follows in relevant part:

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S- X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included.
100. In the section of the 2Q03 Report titled "Management's Discussion and Analysis of Financial Condition and Results of Operation," the Company summarized its results for the quarter as follows:

Our revenue increased from $354.7 million during the six months ended June 30, 2002 to $501.6 million for the same period during 2003 and from $178.4 million during the second quarter of 2002 to $256.1 million during the second quarter of 2003. In addition, our net income increased from $22.3 million during the first six months of 2002 to $38.8 million during the same period in 2003 and from $10.3 million during the second quarter of 2002 to $19.6 million during the second quarter of 2003. For the six months ended June 30, 2003, income from operations increased $26.3 million or 71%, to $63.3 million from $37.0 million for the same period during 2002. During the second quarter of 2003, income from operations increased $15.1 million or 87%, to $32.4 million from $17.3 million for the same period during 2002. Income from operations as a percentage of revenue improved from 10.4% during the first six months of 2002 to 12.6% for the same period during 2003 and from 9.7% during the second quarter of 2002 to 12.6% during the second quarter of 2003. A significant portion of our increases in revenue and income from operations and our improvement in income from operations as a percentage of revenue improvement during the three months and six months ended June 30, 2003 is attributable to the growth and continued maturation of AIU Online, whose operating margin percentage is higher than those of our campus-based schools.

101. In discussing the risks and uncertainties that the Company is exposed to, the 2Q03 Report referred readers to "the factors discussed under 'Management's Discussion and Analysis of Financial Condition and Results of Operations--Risks Related to Our Business' in our Annual Report on Form 10-K/A for our fiscal year ended December 31, 2002." The Form 10-K/A purported to warn investors that the Company is subject to strict regulatory oversight by the U.S. Department of Education, stating as follows regarding the matter:

**Failure to Comply with Extensive Regulations Could Have a Material Adverse Effect on our Business**

*Failure of our U.S. schools to comply with extensive regulations could result in financial penalties, restrictions on our operations or loss of external financial aid funding.*

We derive a significant portion of our revenue from U.S. federal student financial aid programs administered by the U.S. Department of Education. To participate
in these programs, a U.S. institution must obtain and maintain authorization by
the appropriate state agencies, accreditation by an accrediting agency recognized
by the Department of Education, and certification by the Department of
Education. As a result, our U.S. schools are subject to extensive regulation by
these agencies. These regulations cover virtually all phases of our operations,
including our educational programs, facilities, instructional and administrative
staff, administrative procedures, marketing and recruiting, financial operations,
including the payment of refunds to students who withdraw, and financial
strength. These regulations also affect our ability to acquire or open additional
schools, add new educational programs or change our corporate structure. The
agencies that regulate our operations periodically revise their requirements and
modify their interpretations of existing requirements. If one of our schools were
to violate any of these regulatory requirements, we could suffer a financial
penalty. A regulatory agency could also place limitations on our schools’
operations or terminate the schools’ ability to grant degrees and certificates or
their eligibility to receive federal student financial aid funds. We cannot predict
with certainty how all of these requirements will be applied, or whether each of
our schools will be able to comply with all of the requirements in the future.
[Emphasis in original].

102. In the 2Q03 Report, the Company set forth its critical accounting policies
for revenue recognition and allowance for doubtful accounts as previously set forth in the 1Q03
Report and further stated, “Our historical bad debt expense as a percentage of revenue for the
three months ended June 30, 2003 and 2002 was 3.9% and 3.6%, respectively.”

103. The representations referenced above from the Company’s July 22, 2003
press release and 2Q03 Report were each materially false and misleading when made because
they failed to disclose and misrepresented the following material adverse facts, among others:

(a) during the Class Period, CEC had systematically falsified student
records in order to increase graduation and enrollment rates and to conceal problems to help its
schools pass audits conducted by the ACICS and the U.S. Department of Education, among other
agencies;

(b) a material portion of the Company’s reported revenues were
improperly recognized because they were derived through fraudulent business practices, such as
federal grants and financial aid payments made based on records and representations that were falsified by the Company;

(c) the Company’s reported results did not accurately portray the Company’s financial condition because a material portion of those results were attributable to improper accounting practices;

(d) the Company’s allowance for doubtful accounts and bad debt expense were derived from improper accounting practices;

(e) contrary to statements in its press releases, the Company’s success was not attributable solely to the supposed strength of its business or its supposed competitive advantages, rather, a material portion of its results were attributable to fraudulent and prohibited business and accounting practices;

(f) the Company failed to disclose that the Company had falsified student records thereby placing its accreditation at serious risk and jeopardizing the ability of its students to qualify for financial aid, which would have a devastating impact on CEC’s business; and

(g) the Company’s results were not prepared and reported in accordance with GAAP and did not fairly present its actual financial results or condition.

The Third Quarter of 2003

104. On October 21, 2003, CEC reported yet another quarter of “record” results, its 23rd record quarter as a publicly-traded company. The Company summarized its performance for the third quarter and nine months of 2003 as follows:

Third quarter 2003 revenues were $315.7 million, up 60 percent from $197.2 million for the same period last year. Third quarter 2003 net income was $26.9 million, or $0.26 per diluted share, up 90 percent from last year’s net income of $14.2 million, or $0.15 per diluted share. For the nine months ended September 30, 2003, revenues were $817.3 million, up 48 percent from $551.8 million for
the same period last year. Net income for the first nine months of 2003 was $65.8 million, or $0.66 per diluted share, up 80 percent from last year’s net income of $36.5 million, or $0.39 per diluted share.

105. According to the October 21 press release:

Third quarter 2003 new student starts rose 73 percent to approximately 26,100, up from approximately 15,100 for the same period last year. Summer and fall (July through October) new student starts are expected to rise 6.3 percent to approximately 43,400, up from approximately 26,700 a year ago.

Total CEC student population on October 31, 2003 is expected to be approximately 79,500, up 58 percent from approximately 50,400 on October 31, 2002. Of the expected total CEC student population on October 31, 2003, approximately 10,400 students are attributable to the Whitman Education Group acquisition. On a same school basis, total CEC student population is expected to increase year-over-year by approximately 26 percent.

106. In the October 21 press release, CEC provided information on its accounts receivable and bad debt expense as follows:

- Quarterly Days Sales Outstanding (DSOs) for total accounts receivable were 33 days at September 30, 2003. This represents a five-day decrease from the quarterly DSOs at September 30, 2002 of 38 days. The company calculates DSOs by dividing its “Receivables net” by average daily revenue. Average daily revenue is computed by dividing quarterly “Total revenues” by the total number of days in the quarter.

- Bad Debt Expense was 4.8 percent of total revenues for the quarter ended September 30, 2003, compared with 3.9 percent for the quarters ended September 30, 2002 and June 30, 2003.

107. Defendant Larson attributed the reported results to the Company’s successful business plan, stating as follows:

“Career Education Corporation continues to deliver record results, with the third quarter serving as a clear demonstration of the vitality and scalability of our business model,” said John M. Larson, chairman, president and chief executive officer. “Third quarter results were driven by significant revenue and profitability gains in our online business, continued strong organic growth in our on-campus operations, and better than expected results from the recently acquired, former Whitman and INSEEC campuses. All of these factors helped drive our quarterly margin improvement of 210 basis points year-over-year.
"As the results demonstrate, CEC is delivering on all fronts," Mr. Larson said. "The growth of our online business continues to outperform expectations and was the primary contributor to our exceeding third quarter revenue and earnings guidance. Our Online Education Group generated approximately $44 million in revenues during the third quarter and is on course to generate more than $140 million in revenues in 2003. This estimate is significantly higher than our 2002 revenues of $20 million.

108. On November 13, 2003, the Company filed its quarterly report on Form 10-Q for the third quarter of 2003 with the SEC (the "3Q03 Report"). The 3Q03 Report reiterated the financial information contained in the October 21, 2003 press release and was signed by defendants Larson and Pesch.

109. In a section of the 3Q03 Report titled "Basis of Presentation," the Company represented that the financial information contained therein was prepared in accordance with GAAP and fairly presented the Company’s results, stating as follows in relevant part:

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included.

110. In the section of the 3Q03 Report titled "Management’s Discussion and Analysis of Financial Condition and Results of Operation," the Company summarized its results for the quarter as follows:

Our revenue increased from $551.8 million during the nine months ended September 30, 2002 to $817.3 million for the same period during 2003 and from $197.2 million during the third quarter of 2002 to $315.7 million during the third quarter of 2003. In addition, our net income increased from $36.5 million during the first nine months of 2002 to $65.8 million during the same period in 2003 and from $14.2 million during the third quarter of 2002 to $26.9 million during the third quarter of 2003. For the nine months ended September 30, 2003, income from operations increased $47.5 million or 78%, to $108.8 million from $61.3 million for the same period during 2002. During the third quarter of 2003, income from
operations increased $21.2 million or 87%, to $45.5 million from $24.3 million for the same period during 2002. Income from operations as a percentage of revenue improved from 11.1% during the first nine months of 2002 to 13.3% for the same period during 2003 and from 12.3% during the third quarter of 2002 to 14.4% during the third quarter of 2003. A significant portion of our increases in revenue and income from operations and our improvement in income from operations as a percentage of revenue during the three and nine month periods ended September 30, 2003 is attributable to the growth and continued maturation of our Online Education Group, whose operating margin percentage is higher than that of our campus-based schools.

111. In discussing the risks and uncertainties facing the Company, the 3Q03 Report referred readers to, “the factors discussed under ‘Management’s Discussion and Analysis of Financial Condition and Results of Operations--Risks Related to Our Business’ in our Annual Report on Form 10-K/A for our fiscal year ended December 31, 2002.” The Form 10-K/A purported to warn investors that the Company is subject to strict regulatory oversight by the U.S. Department of Education, stating as follows regarding the matter:

**Failure to Comply with Extensive Regulations Could Have a Material Adverse Effect on our Business**

*Failure of our U.S. schools to comply with extensive regulations could result in financial penalties, restrictions on our operations or loss of external financial aid funding.*

We derive a significant portion of our revenue from U.S. federal student financial aid programs administered by the U.S. Department of Education. To participate in these programs, a U.S. institution must obtain and maintain authorization by the appropriate state agencies, accreditation by an accrediting agency recognized by the Department of Education, and certification by the Department of Education. As a result, our U.S. schools are subject to extensive regulation by these agencies. These regulations cover virtually all phases of our operations, including our educational programs, facilities, instructional and administrative staff, administrative procedures, marketing and recruiting, financial operations, including the payment of refunds to students who withdraw, and financial strength. These regulations also affect our ability to acquire or open additional schools, add new educational programs or change our corporate structure. The agencies that regulate our operations periodically revise their requirements and modify their interpretations of existing requirements. If one of our schools were to violate any of these regulatory requirements, we could suffer a financial penalty. A regulatory agency could also place limitations on our schools’ operations or terminate the schools’ ability to grant degrees and certificates or
their eligibility to receive federal student financial aid funds. We cannot predict with certainty how all of these requirements will be applied, or whether each of our schools will be able to comply with all of the requirements in the future. [Emphasis in original].

112. In the 3Q03 Report, defendants reiterated their critical accounting policies on revenue recognition and allowance for doubtful accounts as had been set forth in the 1Q03 and 2Q03 Reports, and further indicated that bad debt expense as a percentage of revenue for the three months ended September 30, 2003 and 2002 was 4.8% and 3.9%, respectively.

113. The representations referenced above from the Company’s October 21, 2003 press release and 3Q03 were each materially false and misleading when made because they failed to disclose and misrepresented the following material adverse facts, among others:

(a) during the Class Period, CEC had systematically falsified student records in order to increase graduation and enrollment rates and to conceal problems to help its schools pass audits conducted by the ACICS and the U.S. Department of Education, among other agencies;

(b) a material portion of the Company’s reported revenues were improperly recognized because they were derived through fraudulent business practices, such as federal grants and financial aid payments made based on records and representations that were falsified by the Company;

(c) the Company’s reported results did not accurately portray the Company’s operations because a material portion of those results were attributable to improper accounting practices;

(d) the Company’s allowance for doubtful accounts and bad debt expense were derived from improper accounting practices;
(e) contrary to statements in its press releases, the Company’s success was not attributable solely to the supposed strength of its business or its supposed competitive advantages, but rather, a material portion of its results were attributable to fraudulent and prohibited business practices;

(f) the Company’s purported risk warnings failed to disclose that the Company had falsified student records and defrauded the federal, state and private agencies which regulate and/or accredit CEC’s schools, thereby placing its accreditation at serious risk and jeopardizing the ability of its students to qualify for financial aid, which would have a devastating impact on CEC’s business; and

(g) the Company’s results were not prepared and reported in accordance with GAAP and did not fairly present its actual financial results or condition.

The Company’s Website Touts CEC’s Historical Results and Expected Growth

114. During the Class Period, CEC’s website, in a page titled “Why Invest in CEC”, touted the strength of CEC’s competitive position, the strong performance of its stock price and the Company’s favorable prospects for continued growth. In relevant part, the Company highlighted the following as reasons to invest in CEC:

CEC’s growth prospects for the future remain bright, for five key reasons.

» CEC is a growth leader in a growth market. Employer demands for a better-educated workforce and societal and demographic trends are creating a larger pool of potential students. CEC is well positioned to benefit because its curricula prepare students for careers in fields where current and future demand is strong. These factors will enable CEC to continue setting the growth pace among providers of private, for-profit post-secondary education.

» CEC’s multi-faceted growth strategy is a proven success. The company consistently has achieved annual internal growth exceeding its stated 20 percent target. Supplementing internal growth are CEC’s 26 acquisitions to date, which have broadened the company’s geographic scope and contributed to growth in both revenues and earnings.
CEC’s demonstrated operational excellence creates a strong competitive advantage that is reflected in: marketing programs that continue to attract students in record numbers from all segments of the potential student population; career-focused educational programs that prepare graduates for successful careers in attractive, high-growth fields; innovative retention programs that help make sure students complete their education; and a graduate placement record that consistently ranks among the industry leaders.

CEC’s entry into the high-potential field of online education provides another avenue to future growth. AIU Online and CTU Online, Online CEC’s Education Group, offers academic programs that capitalize on the full multimedia potential of E-learning and a groundbreaking virtual campus that provides students with a total online learning environment.

Offering a full range of educational options - associate, bachelor’s, master’s, and doctoral degrees and non-degree diploma and certificate programs - enables CEC to meet the educational needs of students throughout their lifetimes as they advance in their careers or make new career choices.

115. The representations referenced above from the Company’s website were each materially false and misleading when made because they failed to disclose and misrepresented the following material adverse facts, among others:

(a) during the Class Period, CEC had systematically falsified student records in order to increase graduation rates and enrollment rates and to pass audits by the ACICS and the U.S. Department of Education, among other agencies;

(b) contrary to the Company’s statements, CEC’s “success” was not attributable solely to the supposed strength of its business or its supposed competitive advantages, rather, a material portion of its results were attributable to fraudulent and prohibited business practices; and

(c) given the inherently unsustainable nature of the source of a material portion of the Company’s revenue, the extraordinary risk of regulatory fines and the risk that the accreditation of its schools could be revoked, the Company’s statements that CEC was poised for continued strong growth was deceptive and provided false comfort to investors.
The Truth Begins to Emerge

116. On November 11, 2003, the Bergen Record, a local New Jersey newspaper, reported that a former director of CEC’s Gibbs College in New Jersey had alleged that the school routinely conferred degrees on students who did not complete required courses or attend mandatory internships. These allegations were made in a wrongful termination action filed by the former director in the Superior Court of New Jersey on November 5, 2003. The former director alleges that she was terminated after repeatedly complaining to her supervisors about the fraudulent business practices she regularly witnessed at the school. Because the story appeared in a local New Jersey daily with very limited circulation, it was not digested by the market and did not immediately affect the Company’s stock price.

117. On November 17, 2003, the Company issued a press release announcing the filing of the wrongful termination action. In a press release, the Company denied the allegations, stating that “[t]he company believes the lawsuit is without merit and intends to vigorously defend itself.” The Company’s stock price plummeted on the news, falling from $52.70 per share on November 14, 2003 to $42.56 per share on November 17 (the next trading day), a one-day drop of 19.2%. However, CEC’s stock price rebounded over the next few weeks as the market shrugged off the allegations in the lawsuit as isolated and unlikely to have a materially negative impact the Company’s overall operations, consistent with the Company’s representations regarding the matter.

118. However, on December 3, 2003, the market learned that similar accusations of wrongdoing were leveled by a highly-placed employee of a different CEC school, in California. On December 3, 2003, Bloomberg News reported that the former registrar of CEC’s Brooks Institute of Photography in Santa Barbara, California alleged filed a complaint with ACICS alleging that the school falsified student records to ensure that the school passed
inspections by accreditation auditors and to increase enrollment. *Bloomberg News* quoted the former registrar as alleging that “*Many staff members have been asked by management to commit forgery, fraud, perjury or whatever is necessary to pass audit inspections.*” (Emphasis added). On December 4, 2003, *The Street.com* reported that the former registrar further quoted the former registrar as stating that “*officials at the school acted illegally and improperly to inflate enrollment and boost the bottom line.*” (Emphasis added).

119. In reaction to this latest revelation, CEC’s stock price plummeted again, falling from $54.76 per share on December 2, 2003 to $39.48 on December 3, 2003, a one-day drop of 28%, on trading volume of 18.2 million shares -- more than nine times the Company’s three-month daily average. In reaction to this latest revelation, CEC’s stock price plummeted again, falling from $54.76 per share on December 2, 2003 to $39.48 on December 3, 2003, a one-day drop of 28%, on trading volume of 18.2 million shares -- more than nine times the Company’s three-month daily average.

120. In early 2004, the SEC commenced an investigation into the allegations against CEC raised by its former employees.

**Defendants’ Class Period Statements Violated GAAP**

121. Throughout the Class Period, CEC and the Individual Defendants issued materially false and misleading statements and omitted to disclose material information regarding CEC’s financial status and used improper accounting practices in violation of GAAP and SEC reporting requirements to falsely inflate and report revenues and earnings.

122. GAAP is recognized by the accounting profession and the SEC as the uniform rules, conventions and procedures necessary to define accepted accounting practices and principles at a particular time. SEC Regulation S-X requires that publicly traded companies
present their annual financial statements in accordance with GAAP. 17 C.F.R. § 210.401(a)(1).

In addition, Regulation S-X requires that interim financial statements also comply with GAAP, with the exception that interim financial statements also comply with GAAP, with the exception that interim financial may omit disclosures which would substantially duplicate those disclosures which accompany the annual financial statements. 17 C.F.R. § 210.10.01(a). Financial statements filed with the SEC that are not prepared in compliance with GAAP are presumed to be misleading and inaccurate.

123. As set forth in Financial Accounting Standard Board ("FASB") Statement of Financial Accounting Concepts ("SFAC") No. 1, one of the fundamental objectives of financial reporting is to provide accurate and reliable information concerning an entity’s financial performance during the period being presented. SFAC No. 1, ¶ 42 states:

Financial reporting should provide information about an enterprise’s financial performance during a period. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investments and credit decisions reflect investors’ and creditors’ expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of enterprise performance.

Additionally, Section 13 of the Exchange Act requires, in part, that companies:

(i) devise and maintain a system of internal controls sufficient to provide reasonable assurances that –

* * *

(ii) transactions are recorded as necessary (I) permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets.

124. SFAC No. 1 states that financial reporting, i.e., financial statements and the related footnote disclosures, is intended to provide information that is useful to the users of the statements in making business and economic decisions. By presenting investors with
financial information that did not reflect the true nature of fraudulent and inappropriate business practices, CEC did not provide useful information in the Company's financial statements.

125. Similarly, SFAC No. 1 states that "[f]inancial reporting is expected to provide information about an enterprise's financial performance during a period and about how management of an enterprise has discharged its stewardship responsibility to owners." By presenting revenues and expenses that were grossed up by fraudulent business practices, defendants did not present the Company's actual financial performance. Results obtained through such business practices do not accurately reflect the Company's operations, are highly deceptive to investors, and are inherently unsustainable.

126. SFAC No. 2 describes the characteristics required to make accounting information useful to the people that use it. One of these characteristics is representational faithfulness, which is defined as "correspondence or agreement between a measure or description and the phenomenon that it purports to represent (sometimes called validity)."

127. Another characteristic defined in SFAC No. 2 is verifiability. Verifiability is "the ability through consensus among measurers to ensure that information represents what it purports to represent or that the chosen method of measurement has been used without error or bias."

128. CEC improperly recognized revenue where the timing or amount of revenue was not recorded in accordance with GAAP. Staff Accounting Bulletin ("SAB") 101 expresses the SEC's Staff's views regarding the application of GAAP to revenue recorded in the financial statements. SAB 101 states that revenue is generally realized or realizable and earned when all of the following criteria are met:

(a) persuasive evidence of an arrangement exists,
(b) delivery has occurred or services have been rendered,

(c) the seller's price to the buyer is fixed or determinable, and

(d) collectibility is reasonably assured.

(See SAB 101, Section A(1)).

129. CEC's Quarterly Reports on Form 10-Q, referenced herein, identify the Company's Critical Accounting Policies as the recognition of tuition revenue on a straight-line basis over the period of instruction. CEC thus has overstated its tuition revenue during the Class Period by failing to have persuasive evidence of valid student enrollments or placements nor fully qualified financial aid to pay for them. In addition, CEC has recognized higher tuition revenue than GAAP permits when it falsified student records to confer degrees or to record the completion of classes, and falsely inflated student enrollment records and statistics. GAAP precludes the recognition of revenue until strong evidence demonstrates and supports the existence of an agreement between both parties. (See SAB 101, Section A(2), Question 1, paragraph 2).

130. CEC also overstated tuition revenue by recognizing revenue prior to the completion of the "earnings process", where services (i.e., classes) have not been rendered to students. CEC (a) did not notify government agencies when students dropped out of school, (b) counted inactive students as active when the students were not attending class, and (c) regularly credited and billed students for courses they never attended. GAAP provides that revenue can be recorded only when CEC completes its obligations (i.e., to provide educational to actual students in accordance with the terms of its contractual agreements, federal, state, and local government regulations, and accrediting agency standards). (See SAB 101, Section A(1), footnote 4, and Concepts Statement 5, paragraphs 84(a), (b), and (d)).
131. Finally, CEC overstated tuition revenue by failing to appropriately account for initial concerns related to the collectibility of student receivables. CEC’s alleged actions include failing to fully qualify for financial aid prior to enrollment (i.e., knowingly not having sufficient third party funding to cover the payment of tuition fees) and failing to refund payments to government agencies for students that were never enrolled at the respective educational institution. GAAP precludes the recognition of revenue when there is an initial concern about whether corresponding revenue can be collected. (See SAB 101, Section A(1), footnote 6).

132. CEC’s materially false and misleading financial statements resulted from a series of deliberate senior management decisions designed to conceal the truth regarding CEC’s actual operating results. Defendants caused the Company to violate GAAP because defendants knew or recklessly disregarded that CEC’s revenues were grossly inflated during the Class Period, as a result of the employment of fraudulent business practices, such as the falsification of documents used to obtain federal financial aid and grants, and the improper manipulation of the allowance for doubtful accounts and bad debt expense.

133. According to numerous former employees, including Witnesses 1 and 3, CEC corporate imposed onto the schools absolutely unrealistic growth/EBIDTA expectations. Personnel at the subordinate schools had no choice but to commit to these essentially unattainable goals if they wanted to keep their jobs. At the end of the quarter, if actual performance did not conform to the expectations imposed by CEC corporate, school controllers were told to “go and find” the monies necessary to meet the goals. The only way this could be done was by deviating from GAAP, which Witness 1 was directed to do by her superiors. Such GAAP deviations included dipping into certain accrual accounts that could be used as “slush funds” to understate various expenses incurred in the period.
134. Such practices were not legitimate practices pursuant to GAAP. GAAP requires that revenues are not recognized until earned. An entity's revenue-earning activities involve delivering goods, rendering services, or other activities that constitute its ongoing major or central operation. Revenues and gains are realizable when related assets received or held are readily convertible to known amounts of cash or claims to cash. Readily convertible assets have (i) interchangeable (fungible) units and (ii) quoted prices available in an active market that can rapidly absorb the quantity held by the entity without significantly affecting the price. SFAC No.5, ¶¶ 83-84. However, by, among other things, falsifying student records, CEC improperly recognized revenue because financial aid payments made by the federal government in reliance on fraudulent records created by CEC is not convertible to known amounts of cash or claims to cash due to their illegitimate nature and risk of disgorgement.

135. In blatant violation of some of the most fundamental accounting rules, CEC devised ways to artificially inflate net income and earnings by improperly understating expenses during the Class Period. CEC understated its expenses in the Class Period and/or improperly delayed expense recognition as long as possible.

136. Several Witnesses indicated that they were pressed into manipulating liability accounts to understate expenses in an attempt to achieve net earnings targets. These Witnesses have acknowledged that there were intentional violations of GAAP in the improper reversal of expense accruals. GAAP requires expenses to be recorded in the period they were incurred. (See Concepts Statement 5, paragraphs 85-87). This Concept is one of, if not the most basic, tenet underlying accrual accounting. CEC, however deliberately or with severe recklessness, ignored this most basic accounting rule, and systematically engaged in a scheme of improperly timing expense recognition.
137. Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins ("ARB") (June 1953) Chapter 3, Section 9 provides that the objective of providing for reserves against receivables is to assure that, "[a]ccounts receivable net of allowances for uncollectible accounts . . . are effectively stated as the amount of cash estimated as realizable." GAAP provides that an estimated loss from a loss contingency, such as the collectibility of receivables, "shall be accrued by a charge to income" if: (i) information available prior to issuance of the financial statements indicated that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements; and (ii) the amount of the loss can be reasonably estimated. SFAS No. 5, ¶ 8. Losses from uncollectible receivables shall be accrued when both conditions in paragraph 8 are met. Those conditions may be considered in relation to individual receivables or in relation to groups of similar types of receivables. If the conditions are met, accrual shall be made even though the particular receivables that are uncollectible may not be identifiable. SFAS No. 5, ¶ 22.

138. SFAS No. 5 also requires that financial statements disclose contingencies when it is at least reasonably possible (e.g., a greater than slight chance) that a loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss, a range of loss or state that such an estimate cannot be made.

139. The SEC considers the disclosure of loss contingencies to be so important to an informed investment decision that it promulgated Regulation S-X, which provides that disclosures in interim period financial statements may be abbreviated and need not duplicate the disclosure contained in the most recent audited financial statements, except even though a significant change since year end may not have occurred." 17 C.F.R. § 210.10-01. APB Opinion No. 28, Interim Financial Reporting (May 1973) ¶ 17 provides in pertinent part:
The amounts of certain costs and expenses are frequently subjected to year-end adjustments even though they can be reasonably approximated at interim dates. To the extent possible such adjustments should be estimated and the estimated costs and expenses assigned to interim periods so that the interim periods bear a reasonable portion of the anticipated annual amount.

140. Thus, a material portion of the tuition payments made to CEC were not legitimate and did not generate revenue that CEC could recognize pursuant to GAAP. As a result, CEC knowingly overstated the Company’s revenue and earnings based on these transactions and understated allowance for doubtful accounts and bad debt expense.

141. Moreover, CEC was grossly reckless in failing to maintain adequate internal accounting controls. In the American Institute of CPA’s Auditing Standards, AU 319.06, “Internal Control in a Financial Statement Audit”, defines internal controls as “a process – effected by an entity’s board of directors, management, and other personnel – designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations.

142. The pervasiveness of the aforementioned allegations involved in CEC’s fraudulent operations and accounting practices suggest there are significant deficiencies, if not material weaknesses, in the Company’s internal controls and disclosure controls. These deficiencies relate to:

(a) the structure and design of certain financial information reporting processes relating to the timing and magnitude of revenue recognition and bad debt expense by CEC;

(b) inadequate or ineffective policies for documenting student enrollment transactions;
(c) inadequate documentation of policies and execution of processes related to accounting for transactions; and

(d) an internal control environment that has allowed fraudulent transactions and accounting manipulations to be recorded by CEC and the Individual Defendants.

Additional Scienter Allegations

143. As alleged herein, defendants acted with scienter in that defendants knew that the press releases, public filings and CEC's website issued or disseminated in the name of the Company were materially false and misleading; knew that such statements or documents would be issued or disseminated to the investing public; and knowingly and substantially participated or acquiesced in the issuance or dissemination of such statements or documents as primary violations of the federal securities laws. As set forth elsewhere herein in detail, defendants, by virtue of their receipt of information reflecting the true facts regarding CEC, their control over, and/or receipt and/or modification of the Company's allegedly materially misleading misstatements and/or their associations with the Company which made them privy to confidential proprietary information concerning CEC, participated in the fraudulent scheme alleged herein.

144. In addition, defendants were strongly motivated to commit the wrongdoing alleged herein in order to allow the Individual Defendants to sell their own shares of the Company's common stock at artificially inflated prices. As is illustrated by the following chart, the Individual Defendants sold a total of 872,000 shares of CEC common stock during the Class Period, reaping gross proceeds in excess of $33.5 million. Other than the exercise of
options, the Individual Defendants made no purchases of CEC common stock. The following insider trading data is adjusted to reflect the 2:1 stock split effective August 25, 2003:

**John M. Larson (CEO, President, Chairman):**

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**Patrick K. Pesch (CFO, Treasurer, Secretary): Price Per Share**

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145. Defendants were further motivated to artificially inflate the Company’s results and stock price so that CEC could complete the strategic acquisition of Whitman Education Group, Inc. using its stock as currency. The fraud allowed the Company to execute the acquisition on more favorable terms than if the truth about its business practices were known. On July 1, 2003, CEC announced that it had acquired Whitman Education Group, Inc. in a combination cash and share exchange transaction valued at $245 million.

146. In addition, the Individual Defendants were motivated to inflate reported financial results so that they could maximize the amount of any bonus received. Indeed, in 2003, the Individual Defendants received bonus compensation which actually exceeded their base salary compensation.

147. The Witnesses’ allegations referenced herein contain multiple indicators of scienter:

i) The accounting improprieties at issue were done by the alleged misuse of facts related to student registration and completion of the academic year.

ii) The sheer number of improper operational and accounting manipulations alleged to have been employed during the Class Period.

iii) The duration over which the allegations of improper accounting were perpetrated.
iv) The types of accounting manipulations employed – as detailed herein, the alleged accounting improprieties did not occur as a result of good faith differences in accounting judgments, or interpretations of complicated or vague accounting rules. The alleged violations of accounting rules and precepts violated by CEC were long established, basic accounting standards and concepts, such as the most basic rule of recording revenue or recognizing an expense in the period it was actually incurred.

v) Improper accounting and internal control weaknesses were widespread, pervasive, systemic, and not limited to one educational center as reported by the Witnesses.

vi) Experienced accounting managers directed the alleged improper accounting – CEC’s financial officers knew what they were doing. They were experienced and seasoned financial professionals.

148. On January 7, 2004, the SEC commenced an informal investigation into CEC.

Undisclosed Adverse Information

149. The market for CEC’s common stock was open, well-developed and efficient at all relevant times. As a result of these materially false and misleading statements and failures to disclose, CEC common stock traded at artificially inflated prices during the Class Period until December 2, 2003. Lead Plaintiff and other members of the Class purchased or otherwise acquired CEC’s common stock relying upon the integrity of the market price of the Company’s common stock and market information relating to CEC, and have been damaged thereby.
150. During the Class Period, defendants materially misled the investing public, thereby inflating the price of CEC common stock, by publicly issuing false and misleading statements and omitting to disclose material facts necessary to make defendants’ statements, as set forth herein not false and misleading. Said statements and omissions were materially false and misleading in that they failed to disclose material adverse information and misrepresented the truth about the Company, its business and operations, as detailed herein.

151. At all relevant times, the material misrepresentations and omissions particularized in this Complaint directly or proximately caused or were a substantial contributing cause of the damages sustained by Lead Plaintiff and other members of the Class. As described herein, during the Class Period, defendants made or caused to be made a series of materially false or misleading statements about CEC’s financial performance and condition and prospects for continued future growth. These material misstatements and omissions created in the market an unrealistically positive assessment of CEC and its prospects and operations, thus causing the Company’s common stock to be overvalued and artificially inflated at all relevant times. Defendants’ materially false and misleading statements during the Class Period resulted in Lead Plaintiff and other members of the Class purchasing the Company’s common stock at artificially inflated prices, thus leading to their losses when the illusion was revealed, and the market was able to accurately value the Company.

Applicability Of Presumption Of Reliance:

**Fraud-On-The-Market Doctrine**

152. At all relevant times, the market for CEC’s securities was an efficient market for the following reasons, among others:

i) CEC stock actively traded on the Nasdaq National Market, a highly efficient and automated market;
ii) As a regulated issuer, CEC filed periodic public reports with the SEC and the Nasdaq;

iii) CEC regularly communicated with public investors via established market communication mechanisms, including through the regular dissemination of press releases on the national circuits of major newswire services and through other wide-ranging public disclosures, such as communications with the financial press and other similar reporting services; and

iv) CEC was followed by several securities analysts employed by major brokerage firms who wrote reports which were distributed to the sales force and certain customers of their respective brokerage firms. Each of these reports was publicly available and entered the public marketplace.

153. As a result of the foregoing, the market for CEC’s securities promptly digested current information regarding CEC from all publicly available sources and reflected such information in CEC’s stock price. Under these circumstances, all purchasers of CEC’s securities during the Class Period suffered similar injury through their purchase of CEC’s securities at artificially inflated prices and a presumption of reliance applies.

**No Safe Harbor**

154. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this complaint. Many of the specific statements pleaded herein were not identified as “forward-looking statements” when made. To the extent there were any forward-looking statements, there were no meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements.
Alternatively, to the extent that the statutory safe harbor does apply to any forward-looking statements pleaded herein, defendants are liable for those false forward-looking statements because at the time each of those forward-looking statements was made, the particular speaker knew that the particular forward-looking statement was false, and/or the forward-looking statement was authorized and/or approved by an executive officer of CEC who knew that those statements were false when made.

**FIRST CLAIM**

Violation Of Section 10(b) Of
The Exchange Act And Rule 10b-5
Promulgated Thereunder Against All Defendants

155. Lead Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

156. During the Class Period, CEC and the Individual Defendants, and each of them, carried out a plan, scheme and course of conduct which was intended to and, throughout the Class Period, did: (i) deceive the investing public, including Lead Plaintiff and other Class members, as alleged herein; (ii) artificially inflate and maintain the market price of CEC’s securities; and (iii) cause Lead Plaintiff and other members of the Class to purchase CEC’s securities at artificially inflated prices. In furtherance of this unlawful scheme, plan and course of conduct, defendants, and each of them, took the actions set forth herein.

157. Defendants (a) employed devices, schemes, and artifices to defraud; (b) made untrue statements of material fact and/or omitted to state material facts necessary to make the statements not misleading; and (c) engaged in acts, practices, and a course of business which operated as a fraud and deceit upon the purchasers of the Company’s securities in an effort to maintain artificially high market prices for CEC’s securities in violation of Section 10(b) of
161. The defendants had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose such facts, even though such facts were available to them. Such defendants' material misrepresentations and/or omissions were done knowingly or recklessly and for the purpose and effect of concealing CEC's operating condition and future business prospects from the investing public and supporting the artificially inflated price of its securities. As demonstrated by defendants' overstatements and misstatements of the Company's business, operations and earnings throughout the Class Period, defendants, if they did not have actual knowledge of the misrepresentations and omissions alleged, were reckless in failing to obtain such knowledge by deliberately refraining from taking those steps necessary to discover whether those statements were false or misleading.

162. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, the market price of CEC's securities was artificially inflated during the Class Period. In ignorance of the fact that market prices of CEC's publicly-traded securities were artificially inflated, and relying directly or indirectly on the false and misleading statements made by defendants, or upon the integrity of the market in which the securities trade, and/or on the absence of material adverse information that was known to or recklessly disregarded by defendants but not disclosed in public statements by defendants during the Class Period, Lead Plaintiff and the other members of the Class acquired CEC securities during the Class Period at artificially high prices and were damaged thereby.

163. At the time of said misrepresentations and omissions, Lead Plaintiff and other members of the Class were ignorant of their falsity, and believed them to be true. Had Lead Plaintiff and the other members of the Class and the marketplace known of the true
financial condition and business prospects of CEC, which were not disclosed by defendants, Lead Plaintiff and other members of the Class would not have purchased or otherwise acquired their CEC securities, or, if they had acquired such securities during the Class Period, they would not have done so at the artificially inflated prices which they paid.

164. By virtue of the foregoing, defendants have violated Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder.

165. As a direct and proximate result of defendants’ wrongful conduct, Lead Plaintiff and the other members of the Class suffered damages in connection with their respective purchases and sales of the Company’s securities during the Class Period.

SECOND CLAIM

Violation Of Section 20(a) Of The Exchange Act Against the Individual Defendants

166. Lead Plaintiff repeats and realleges each and every allegation contained above as if fully set forth herein.

167. Each of the Individual Defendants acted as a controlling person of CEC within the meaning of Section 20(a) of the Exchange Act as alleged herein. By virtue of their high-level positions, and their ownership and contractual rights, participation in and/or awareness of the Company’s operations and/or intimate knowledge of the statements filed by the Company with the SEC and disseminated to the investing public, the Individual Defendants had the power to influence and control and did influence and control, directly or indirectly, the decision-making of the Company, including the content and dissemination of the various statements which Lead Plaintiff contends are false and misleading. The Individual Defendants were provided with or had unlimited access to copies of the Company’s reports, press releases, public filings and other statements alleged by Lead Plaintiff to be misleading prior to and/or
JURY TRIAL DEMANDED

Lead Plaintiff hereby demands a trial by jury.

Dated: June 17, 2003

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LASKY & RIFKIND, LTD.
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Chicago, IL 60610
Ph: (312) 634-0057
Fax: (312) 634-0059
Local Counsel for Lead Plaintiff

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Emily C. Komlossy
Christopher J. Keller
GOODKIND LABATON RUDOFF &
SUCHAROW LLP
100 Park Avenue
New York, New York 10017-5563
(212) 907-0700

Attorneys for Lead Plaintiff
CERTIFICATION

I, Thomas J. Schroder, hereby certify as follows:

1. I am fully authorized to enter into and execute this Certification. I have reviewed a complaint prepared against Career Education Corporation ("CEC") alleging violations of the federal securities laws and I authorized the filing of this complaint;

2. I did not purchase securities of CEC at the direction of counsel or in order to participate in any private action under the federal securities laws;

3. I am willing to serve as a lead plaintiff in this matter, including providing testimony at deposition and trial, if necessary;

4. I have transactions in the securities of CEC as reflected in Exhibit A hereto;

5. I have not sought to serve as a lead plaintiff in any class action under the federal securities laws during the last three years, except for the following:

6. Beyond my pro rata share of any recovery, I will not accept payment for serving as a lead plaintiff on behalf of the class, except the reimbursement of such reasonable costs and expenses (including lost wages) as ordered or approved by the Court.

I declare under penalty of perjury, under the laws of the United States, that the foregoing is true and correct.

Dated: 12/29/03

[Signature]