AMERICAN PUBLIC EDUCATION INC
Form 10-K
February 28, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

[X] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2012

or

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ______ to ______

Commission File Number: 001-33810

American Public Education, Inc.
(Exact name of registrant as specified in its charter)

Delaware	01-0724376
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

111 West Congress Street
Charles Town, West Virginia 25414
(Address, including zip code, of principal executive offices)

(304) 724-3700
(Registrant’s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.01 par Value	The NASDAQ Stock Market

Securities registered pursuant to section 12(g) of the Act:
None
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o   No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o   No þ

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The total number of shares of common stock outstanding as of February 25, 2013, was 17,802,678.

The aggregate market value of the registrant's common stock held by nonaffiliates computed by reference to the price at which the common equity was last sold as of June 30, 2012, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $536 million. For purposes of this calculation, shares of common stock held by stockholders whose ownership exceeds 10 percent of the common stock outstanding at June 30, 2012, the Registrant's chief executive officer, the Registrant's chief financial officer, and the Registrant's directors were excluded. Exclusion of such shares held by any person should not be construed to indicate that the person possesses the power, direct or indirect, to direct or cause the direction of the management or policies of the Registrant, or that the person is controlled by or under common control with the Registrant.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant's Definitive Proxy Statement for its 2013 Annual Meeting of Stockholders (which is expected to be filed with the Commission within 120 days after the end of the registrant's 2012 fiscal year) are incorporated by reference into Part III of this Report.

AMERICAN PUBLIC EDUCATION, INC.

FORM 10-K
INDEX

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This annual report, including the sections entitled “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and “Business,” contains forward-looking statements. We may, in some cases, use words such as “project,” “believe,” “anticipate,” “plan,” “expect,” “estimate,” “intend,” “should,” “would,” “could,” “potential “may,” or other words that convey uncertainty of future events or outcomes to identify these forward-looking statements. Forward-looking statements in this annual report include statements about:

- our ability to comply with the extensive regulatory framework applicable to our industry, including Title IV of the Higher Education Act of 1965, as amended, and the regulations thereunder, as well as state law and regulations and accrediting agency requirements;
- the pace of growth of our enrollment;
- our conversion of prospective students to enrolled students and our retention of active students;
- our ability to update and expand the content of existing programs and the development of new programs in a cost-effective manner or on a timely basis;
- our maintenance and expansion of our relationships with the United States Armed Forces and various organizations and the development of new relationships;
- the competitive environment in which we operate;
- our cash needs and expectations regarding cash flow from operations;
- our ability to maintain and develop our technology infrastructure, and the ability of our proprietary systems to support a larger student body;
- our ability to manage and grow our business and execution of our business and growth strategies; and
- our financial performance generally.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements. There are a number of important factors that could cause actual results to differ materially from the results anticipated by these forward-looking statements, which apply only as of the date of this annual report. These important factors include those that we discuss in Item 1A “Risk Factors,” Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere. You should read these factors and the other cautionary statements made in this annual report as being applicable to all related forward-looking statements wherever they appear in this annual report. If one or more of these factors materialize, or if any underlying assumptions prove incorrect, our actual results, performance, or achievements may vary materially from any future results, performance, or achievements expressed or implied by these forward-looking statements. We undertake no obligation to publicly update any forward-looking statements after the date of this annual report, whether as a result of new information, future events, or otherwise, except as required by law.

PART I

ITEM 1. BUSINESS

Company Overview

American Public Education, Inc. is a provider of exclusively online postsecondary education with an emphasis on serving the needs of the military and public service communities. We operate through two universities: American Military University, or AMU, and American Public University, or APU. Together, AMU and APU constitute the American Public University System, or APUS. Our universities share a common faculty and curriculum, which includes 87 degree programs and 69 certificate programs in disciplines related to national security, military studies, intelligence, homeland security, criminal justice, technology, business administration, education, nursing, and liberal arts. We currently serve approximately 127,000 students living in all 50 states and the District of Columbia in the United States, as well as in various international locations. Our university system is regionally accredited.

From 2010 to 2012, our total revenue increased from $198.2 million to $313.5 million, which represents a compound annual growth rate of 26%. Our net registrations increased 18% and 32% in 2012 and 2011, respectively, over the prior periods. We believe our growth is attributable to: (i) high student satisfaction and referral rates; (ii) regional accreditation; (iii) increasing acceptance of distance learning within our targeted markets; and (iv) the variety and affordability of our programs. As our revenue base grows, we expect our growth rate percentages to continue to decline. However, we expect actual dollar revenue growth to increase. Net income improved to $42.3 million in 2012 from $29.9 million in 2010.

Approximately 57% of our students serve in the United States military on active duty. The remainder of our students are generally civilians, many with careers in public service, such as federal, national, and local law-enforcement personnel or other first responders, or they are civilians who are military-affiliated professionals, such as veterans, reservists, or National Guard members. Our programs are generally designed to prepare individuals for productive contributions to their professions and society, as well as to potentially advance their current professions or prepare for their next career. Our online method of instruction is well-suited to our students, many of whom serve in positions requiring extended and irregular schedules, are on-call for rapid response missions, participate in extended deployments and exercises, travel or relocate frequently, and have limited financial resources. Our satisfied students have been a significant source of referrals for us, which we believe has led to lower marketing costs among certain of our student populations.

As of December 31, 2012, we had approximately 430 full-time and over 1,570 adjunct faculty. Nearly all of our faculty members have advanced degrees and many of them have leadership experience in their fields. Our adjunct faculty also includes professors who teach at leading national and state universities. We believe quality faculty members are attracted to us because of the high percentage of military and public service professionals in our student body who can immediately apply lessons learned in our classroom to their daily work. In addition, our faculty members are attracted to the flexible nature of teaching online and the numerous support services we provide to them. Our faculty is organized into several departments under the leadership of a Provost who reports to our President and is under the supervision of a nine-member Board of Trustees.

We have invested significant capital and resources in developing proprietary information systems and processes to support what we refer to as Partnership At a Distance™, or PAD. PAD is the patented approach to how we interact with our students. At its center is a dynamic information system enabling us to recognize that every student is unique and to provide individualized support at appropriate times from pre-enrollment through and beyond graduation, including student advising, administrative support, and community networking. By avoiding a one-size-fits-all approach, the system provides the flexibility to maintain a highly-engaged partnership with our learners based on their preferences. PAD has allowed us to scale and improve the quality of our academic offerings and student support.

Our systems and processes also help us measure and manage the activities of our faculty, student support personnel, and prospective and active students, allowing us to continuously improve our academic quality, student support services, and marketing efficiency. We believe these proprietary systems and processes will support a much larger institution and provide us important competitive and cost advantages. However, we also believe that we need to continue to invest in our systems and new technologies in order to stay competitive and relevant to adult learners.

History

We were founded as American Military University in 1991 and began offering courses in January 1993. Our founder, a retired Marine officer, established American Military University as a distance learning graduate-level institution, specializing in a military studies curriculum for military officers seeking an advanced degree relevant to their profession. Following initial national accreditation by the Accrediting Commission of the Distance Education and Training Council, or DETC, in 1995, American Military University began offering undergraduate programs primarily directed to members of the armed forces in January 1996. American Military University gradually broadened its military studies curriculum over the next three years to include defense management, civil war studies, intelligence, and unconventional warfare, and later expanded into military-related disciplines, such as criminal justice, emergency management, national security, and homeland security. Over time, American Military University diversified its educational offerings into the liberal arts in response to demand by military students for post-military career preparation. With its expanded program offerings, American Military University began to attract the greater public service community, primarily police, fire, emergency management personnel, and national security professionals. In 2002, we reorganized the operations of American Military University into our current university system and began operating through two universities, AMU and APU. The purpose of the reorganization was, in part, to establish an institution brand, APU, that would appeal to non-military markets, including public service professionals such as teachers.

Our university system achieved regional accreditation in May 2006 with The Higher Learning Commission of the North Central Association of Colleges and Schools (Higher Learning Commission). In July 2011, The Higher Learning Commission reaffirmed accreditation of APUS for online courses and programs without any other stipulations on its affiliation status. Our next comprehensive evaluation is scheduled for the 2020-2021 academic year, with an interim progress report on development of university system-wide coordination and improvement of graduate studies due in July 2015. In 2012, we received approval from The Higher Learning Commission to offer a new degree program in Electrical Engineering.

Since the founding of American Military University, we have gradually transitioned from a military focus to a broader focus on the military, public services, and civilian communities. We expect the percentage of our students that are not eligible for tuition assistance programs of the Department of Defense, or DoD, to continue to increase, particularly as a result of our eligibility to participate in Title IV programs. Furthermore, because our students who use the DoD tuition assistance programs generally take fewer courses at one time than our other students, they represent a smaller percentage of our net enrollment than they do of our total student body. In 2012, we announced plans that may expand our focus to include international students through a new investment in, and relationship with, New Horizons Worldwide, Inc., a global independent I.T. training company.

Market Overview

Within the postsecondary education market, we believe that there is significant opportunity for growth in online programs. We believe that increasing requirements for workers to have job mobility and critical skills, combined with the growing acceptance of online learning from employers and the flexibility associated with online learning, should attract more students, both traditional and adult, to distance learning.

There are more than 2.2 million active and reserve military professionals in the United States Armed Forces. Historically, approximately 300,000 new service members are enlisted or commissioned to replace retiring and separating members each year. However, this number is likely to decrease if, as proposed, the military downsizes forces incrementally. We believe that the unpredictable and demanding work schedules of military personnel and their geographic distribution make online learning and asynchronous teaching particularly attractive to them. Military leaders and policies promote voluntary education programs as a means for service members to gain the knowledge and skills that will improve their military performance as well as prepare them for a career following their military service. Academic achievement can also result in increased rank and pay for service members. The United States Armed Forces recognize academic achievement through awarding promotion points for academic credits, specifying education level eligibility requirements for assignments, promotions, and service schools, and entering remarks on performance appraisals.

Active duty and reserve component military personnel are eligible for tuition assistance through the DoD’s Uniform Tuition Assistance Program. DoD policy allows for payment of 100% of a military student’s tuition costs, up to $250 per semester credit hour and a maximum benefit of $4,500 per fiscal year. Our undergraduate tuition per course is designed so that the tuition assistance paid by the service branches covers the cost of our courses for service members up to the annual maximum benefit. Eligible military students may also use their benefits under the Montgomery GI Bill or the Post-9/11 Veterans Educational Assistance Act of 2008, or the Post-9/11 GI Bill, as amended, to pay for tuition costs above the DoD limits through the GI Bills’ Top-Up feature, which is administered by the U.S. Department of Veterans Affairs. Most military veterans are eligible to use their GI Bill entitlements to continue their education after retirement or separation. The DoD announced in October 2011 that, while it will maintain the current levels of tuition assistance in the near term, it plans to consider changes as part of a holistic review of the military compensation package. See “Regulation of Our Business— Nature of Federal, State and Private Financial Support for Postsecondary Education” below for more information on tuition assistance.

Over the last several years, a number of our competitors have expanded their outreach and marketing efforts to the active-duty and reserve component military and veteran population. We believe this is related to a growing desire among for-profit institutions to seek new sources of revenue outside of Title IV programs, which is driven by concerns with a compliance obligation under the Higher Education Opportunity Act, commonly referred to as the “90/10 Rule,” which prohibits proprietary institutions from deriving from Title IV funds, on a cash accounting basis (except for certain institutional loans) for any fiscal year, more than 90% of its revenues (as computed for 90/10 Rule purposes). We believe that for-profit schools seek to attract military students in order to comply with the 90/10 Rule, as DoD tuition assistance and veterans education benefits currently do not count towards the 90% limit. See “Regulation of Our Business—Regulation of Title IV Financial Aid Programs—The ‘90/10 Rule’” below for more information on the 90/10 Rule, including recent proposals to count DoD tuition assistance and veterans education benefits toward the 90% limit.

Our results in any quarter may not indicate the results we may achieve in any subsequent quarter or full year. Our revenues and operating results normally fluctuate as a result of seasonal or other variations in our enrollments. Student population varies as a result of new enrollments, graduations, student attrition, the success of our marketing programs and other reasons that we cannot always anticipate. While our number of enrolled students has grown in each sequential quarter over the past three years, the number of enrolled students has been proportionally greatest in the fourth quarter of each respective year. We expect quarterly fluctuations in operating results to continue as a result of seasonal enrollment patterns.

We believe that civilian students, including those in national security, homeland security, and public safety professions, represent a large market for online education. As with their military counterparts, civilian working adult students have unique program requirements as well as unpredictable and demanding work schedules that often prevent them from attending traditional universities. In addition, we believe academic programs in fields such as nursing, education and liberal arts are also attractive programs to certain prospective students. We also believe that international students represent a large and growing market for quality online education, particularly at institutions with affordable tuition levels.

The growing acceptance of online education has led to an increasing number of traditional universities offering online programs. While this increase represents growing competition for our institution, we also believe that it represents the opportunity to partner with and/or provide education hosting and other student services to universities, other institutions of higher learning, and to corporations.

Competitive Strengths

We believe that we have the following competitive strengths:

Online Higher Education and a Diverse Array of Programs — We have designed our courses and programs specifically for online delivery, and we recruit and train faculty exclusively for online instruction. Because our students are located around the globe, we focus our instruction on asynchronous, interactive instruction that provides students the flexibility to study and interact during the hours of the day or days of the week that suit their terms and schedules. APUS offers 87 degree programs in fields ranging from homeland security, space studies, and emergency and disaster management to liberal arts and education.

Commitment to Academic Excellence — Our academic programs are overseen by our Board of Trustees, which counts as members two former college presidents, active accreditation peer evaluators, a former Commandant of the Marine Corps, and a former Department of the Army Inspector General. We are committed to continuously improving our academic programs and services, as evidenced by the level of attention and resources that we apply to instruction and educational support.

Affordable Tuition — Our combined tuition, fees, and books are less for undergraduate and graduate students than the average in-state cost at a public university. Tuition was established at a competitive rate whereby DoD tuition assistance programs fully cover the cost of undergraduate course tuition and over 75% of the cost of graduate course tuition. We have not increased our undergraduate tuition rate of $250 per credit hour since 2000.

Effective Student Support Systems and Data Driven Decision-Making — Through PAD, students may access our admission, orientation, course registrations, tuition payments, book requests, grades, transcripts, degree progress, and various other services online 24/7. We also have created management tools based on the data from PAD that help us to improve continuously our academic quality, student support services, and marketing efficiency.

Growth Strategies

We believe our growth in student enrollment and revenue has consistently been driven by high student satisfaction and referral rates, and by increasing acceptance of distance learning within our targeted markets. Between 2010 and 2011, we grew our revenue 31% from $198.2 million to $260.4 million. Our revenues increased by 20% to $313.5 million for the year ended December 31, 2012. As our revenue base grows, we expect our growth rate percentages to continue to decline. To expand our business, we plan to employ the following strategies:

Continue Serving the Military Market — We have focused on the needs of the military community since our founding. The combination of our online model, focused curriculum, and outreach to the military has enabled us to gain market share from more established schools, many of which are traditional brick and mortar schools that have served this market for longer periods.

Broaden Our Acceptance in the Public Service and Civilian Markets — We design our curriculum to be relevant to federal, state, and local law enforcement, first responders, and other public service professionals. We believe that the affordability, quality, and diversity of our academic program offerings, including our liberal arts degrees, are attractive options for civilian students.

Add New Degree Programs — Over the long term, we plan to expand our degree offerings to meet our students' needs and marketplace demands with a focus on new programs in fields exhibiting higher than average growth. In addition, we are currently preparing our institution academically and culturally to potentially offer doctoral programs within the next few years.

Pursue and Expand Strategic Partnerships — We believe that articulation agreements and partnerships with institutions of higher learning, corporations, professional associations, and other organizations are important to our enrollment growth and to expanding access to higher education.

Provide Education Hosting and Support Services — We have recently begun to offer hosting and support services to traditional universities and other institutions of higher learning to support online offerings. We believe the growth of online programs at traditional universities, combined with the attractiveness of our distance learning platform, represents an attractive business opportunity to provide such services to smaller universities as a low-cost, high-quality provider of online education.

Explore International Opportunities — We are developing partnerships and other initiatives aimed at expanding international access to our affordable online programs that will further increase the diversity of our student population, enhance the learning environment, and diversify our tuition funding sources. In addition, we plan to pursue other relationships, partnerships, and business opportunities that may expand our international reach, including the development of new international relationships, corporate training programs, and non-degree certifications.

To assist us in achieving elements of our growth strategy or to further develop our business capabilities, we will continue to consider and may pursue strategic investments and acquisitions. For example, on September 30, 2012, we made a $6.8 million or approximately 19.9% investment in preferred stock of NWHW Holdings, Inc., which in turn acquired New Horizons Worldwide, Inc., or New Horizons. In connection with this investment in NWHW Holdings, Inc., we also extended $6.0 million in credit to New Horizons in exchange for a subordinated note. New Horizons is a global IT training company operating over 300 locations around the world through franchise arrangements in 45 states and 70 countries. In connection with the investment, we are entitled to certain rights, including right to representation on the board of directors of NWHW Holdings. Future strategic investments or acquisitions could include investments in, partnerships or joint ventures with, or the acquisition of other schools, service providers or education technology related companies, among other types of entities.

Accreditation

American Public University System is accredited by The Higher Learning Commission and is a member of the North Central Association of Colleges and Schools (www.ncahlc.org). The Higher Learning Commission accredits degree-granting institutions located in a 19-state region, including West Virginia, and is recognized by the U.S. Department of Education. The Higher Learning Commission initially granted us candidacy status in February 2004. We received accreditation from The Higher Learning Commission in May 2006. In July 2011, The Higher Learning Commission reaffirmed accreditation of APUS for online courses and programs without any other stipulations on its affiliation status. Our next comprehensive evaluation is scheduled for the 2020-2021 academic year, with an interim progress report on development of university system-wide coordination and improvement of graduate studies due in July 2015. We were also accredited by the Accrediting Commission of the Distance Education and Training Council, or DETC, until April 30, 2012, when we voluntarily withdrew our accreditation. We have always identified The

Higher Learning Commission as our primary accreditor for Title IV purposes. Therefore, our withdrawal of DETC accreditation did not affect our Title IV participation.

In addition to our university-wide accreditation with the Higher Learning Commission, our Associate of Arts in Business Administration, Bachelor of Business Administration, Bachelor of Arts in Marketing, and Master of Business Administration programs have a specialized accreditation from the Accreditation Council for Business Schools and Programs and our Bachelor of Science in Nursing has specialized accreditation from the Commission on Collegiate Nursing Education. In addition, we have obtained professional recognition for our Emergency and Disaster Management program from the Foundation for Higher Education Accreditation, for our Management program from the Society of Human Resources, for our Sports and Health Sciences program from the American Sport Education Program, and for our Child and Family Development program from the National Council on Family Relations. Maintaining our specialized accreditations and professional recognitions and obtaining other specialized accreditations and professional recognitions will continue to become a more important part of our marketing and outreach efforts to prospective students.

Curriculum and Scheduling

We offer 156 degree and certificate programs. Academic terms begin on the first Monday of each month, with over 2,200 classes in over 1,000 unique courses in either eight- or sixteen-week formats. Semesters and academic years are established to manage requirements for participation in Title IV programs and to assist students who are utilizing Title IV programs in meeting eligibility requirements.

Programs	Number
Master of Arts	17
Master of Business Administration	1
Master of Education	3
Master of Public Administration	1
Master of Public Health	1
Master of Science	6
Bachelor of Arts	24
Bachelor of Business Administration	1
Bachelor of Science	12
Associate of Arts	13
Associate of Science	8
	87
Certificates	
Graduate	34
Undergraduate	35
TOTAL	156

At the graduate level, we offer degree programs in the following disciplines:

Masters of Arts in:

Criminal Justice

Emergency Management and Disaster Management

History

Homeland Security

Humanities

Intelligence Studies

International Relations and Conflict Resolution

Legal Studies

Management

Military History

Military Studies

National Security Studies

Political Science

Psychology

Reverse Logistics Management

Security Management

Transportation Management and Logistics

Master of Business Administration

Master of Education in:

Administration and Supervision

Guidance Counseling

Teaching

Master of Public Administration

Master of Public Health

Master of Science in:

Accounting

Environmental Policy and Management

Information Technology

Space Studies

Sports and Health Sciences

Sports Management

At the undergraduate level, we offer degree programs in the following disciplines:

Bachelor of Arts in:

Child and Family Development

Criminal Justice

Emergency and Disaster Management

English

General Studies

History

Homeland Security

Hospitality Management

Intelligence Studies

International Relations

Management

Marketing

Middle Eastern Studies

Military History

Military Management and Program Acquisition

Philosophy

Political Science

Psychology

Religion

Retail Management

Reverse Logistics Management

Security Management

Sociology

Transportation and Logistics Management

Bachelor of Business Administration

Bachelor of Science in:

Accounting

Criminal Justice

Environmental Studies

Fire Science Management

Information System Security

Information Technology

Information Technology Management

Legal Studies

Nursing

Public Health

Space Studies

Sports and Health Sciences

Associate of Arts in:

Business Administration

Communication

Counter-Terrorism Studies

Criminal Justice

Early Childhood Care and Education

General Studies

History

Hospitality

Management

Military History

Real Estate Studies

Retail Management

Weapons of Mass Destruction Preparedness

Associate of Science in:

Accounting

Computer Applications

Database Application Development

Explosive Ordnance Disposal

Fire Science

Paralegal Studies

Public Health

Web Publishing

Our certificate programs generally consist of a minimum of 18 semester hours of required courses focusing on a particular component of the broader degree program. Students may earn discrete certificates or earn certificates in combination with work toward a degree program.

Lead Generation and Student Recruitment

We have traditionally focused on a relationship-based marketing strategy striving to build long term, mutually beneficial relationships with organizations and individuals in the military and public service communities. Beginning in late 2010, we began to expand our efforts to attract civilian students by creating greater awareness of our APU brand. We believe that people in the military and public service communities tend to be tightly knit affinity groups, which greatly facilitates personal referrals from influential members as well as from current students and alumni to prospective students. Using this approach has enabled us to achieve student acquisition costs that we believe are substantially less than the industry average. We have also supplemented our relationship-based marketing with multi-faceted interactive marketing campaigns (organic search, pay-per-click and banner advertising, and participation in online social communities, among other methods) to help build brand awareness and drive inquiries, and beginning in 2011 and through 2012, we began utilizing a greater percentage of traditional media advertising. Our experience is that the students that these new forms of marketing attract do not perform as well as the students that our relationship based strategy has historically attracted. As we continue to grow, we will need to continue to focus on and improve the utilization of marketing channels that will support our growth by attracting a greater proportion of students that we believe will be successful in the long-term.

The changes to our marketing approach related to our expansion in non-military markets are the primary drivers of the increases in our student acquisition costs that we have experienced. As we continue to grow in size and diversity, our student acquisition costs may continue to increase and we may have a harder time attracting students that perform well over the long term.

Admissions

Our universities welcome qualified individuals to apply for admission at any time through an online application process. The current qualifications for most of our undergraduate programs are a high school diploma or General Education Development certificate. Graduate applicants must hold a baccalaureate degree from an accredited U.S. institution or an equivalent foreign institution.

Prospective students apply directly online. Upon completing the online application and orientation, students are issued a student ID number and password and are provided information for submitting the necessary documentation to finalize their admission and apply for evaluation of credits that they would like to transfer. Students are also informed how to register for their initial course(s), arrange for tuition payment and navigate the online student environment. Prospective students who have questions during the admissions process may obtain assistance through our online resources and can contact the Admissions Department through our online resources or by telephone.

Tuition, Books and Fees

We believe that our ability to provide affordable programs is one of our competitive strengths. We have maintained our undergraduate tuition costs to be lower than public, in-state rates on average and in line with DoD tuition ceilings. Undergraduate tuition is $250 per semester credit hour, or $750 per three-credit course. Since 2000, we have not raised undergraduate tuition rates per semester credit hour. If we were to implement a tuition increase, or if the DoD were to lower the amount of tuition assistance per semester credit hour, military students eligible for the U.S. Department of Veterans Affairs' GI Bill may apply that entitlement to cover the difference through the Top-Up feature. A full 121-semester hour undergraduate degree may be earned for $30,250, plus applicable fees. Eligible undergraduate students receive their textbooks at no cost to them through our book grant program, which represents a potential average student savings over the course of a degree of approximately $4,800 when compared to four-year colleges according to The College Board Study, Annual Trends in College Pricing report from 2012.

Many students transfer in a significant amount of prior credit earned, which also reduces the cost and time of earning their degrees.

Graduate tuition is currently $325 per semester hour, or $975 per three-semester credit hour course. For military students, the service branch pays $750 of the tuition costs per course, and students have the option of paying the remainder out of pocket or applying their GI Bill entitlements to cover the cost above $750. At these tuition rates, students may earn a graduate degree for less than $12,000 in tuition costs for most of our programs.

We do not charge an admission fee, nor do we charge fees for services such as registration, course drops, and similar events that trigger fees at many other institutions. In addition, as a fully-online institution of higher learning, there are no resident fees, such as for parking, food service, student union, and recreation. While we charge a fee for transfer credit evaluation for non-active duty military students and civilian students, unlike transfer credit fees at many institutions, the fee is a one-time, flat fee that does not increase as more credits are transferred. A technology fee of $50 per course was also implemented for course registrations beginning after September 1, 2012. However, APUS provides a grant to cover the fee for active duty military, national guard and reserve personnel, and for anyone using DoD tuition assistance benefits. The grant also covers the fee for students using veterans education benefits.

In addition to military and veterans benefits, we offer a variety of federal and non-federal aid programs to assist students with their education costs. Net course registrations by students using federal student aid programs under Title IV constituted 36.2% of our net registrations in 2012, and we expect that the ability to participate in these programs is important to our growth. The following aid sources are available from military, federal, state, agency, and local organizations to help students meet their education goals:

Military and Veterans Student Aid

- Training Funds
- Tuition Assistance
- Veterans Administration Benefits (Montgomery G.I. Bill or Post 9/11GI Bill)

Other Federal Student Aid, Including Title IV Programs

- Federal Pell Grant
- Federal Subsidized Stafford Loan
- Federal Unsubsidized Stafford Loan
- Federal PLUS Loan
- Federal Graduate PLUS Loan
- Teacher Education Assistance for College and Higher Education (TEACH) Grant

Non-Federal Student Aid

- Employer Voucher

Private Loans

Undergraduate Book Grant

See the discussion under “Regulation of Our Business” below for more information about military and veterans benefits and federal student aid, including the discussions of potential changes to these programs under “Regulation of Our Business—Nature of Federal, State and Private Financial Support for Postsecondary Education—Tuition Assistance” and “Regulation of Our Business—Regulation of Title IV Financial Aid Programs—The ‘90/10 Rule’”.

Enrollment and Student Body

Our active student body consists of approximately 127,000 students, most of whom hold full-time employment. Active students are defined as those who have completed a course in the past twelve months, or are currently enrolled or registered for an upcoming course. We disenroll students who fail to register for and complete at least one course in a calendar year, although they may later apply for re-admission and active status. Students on extended military deployments may apply for a program hold, which keeps them active until they return and are able to resume their studies.

Faculty

As of December 31, 2012, our faculty consists of approximately 2,000 members with relevant teaching and practitioner experience. Approximately 430 members were designated as full-time faculty, and more than 1,570 members were serving as adjunct faculty. A significant majority of our graduate faculty hold a doctorate in the relevant field, while virtually all undergraduate faculty have earned a graduate degree. Exceptions have been granted for a limited number of faculty that may not meet the degree standards, but evidence significant experience and achievement in the subject area that they teach.

We establish full-time and adjunct positions based on program and course enrollment. Many full-time faculty began their career with us as adjunct members. As enrollment increases, we expect to establish additional full-time positions as well as additional adjunct positions.

We attract faculty through referrals by current faculty members, advertisements in education and trade association journals, and our Internet presence. Program Managers and Department Chairs review applications and conduct interviews. We check references prior to offering positions to new faculty and, upon selection, we require each new faculty member to complete an orientation and training program that leads to their certification and assignment. Many of our faculty members have relevant experience at leading universities and within military and governmental institutions. We believe that the composition of our student body and course curriculum is particularly attractive to potential faculty members because of the opportunity to teach relevant material to students that are involved on a daily basis in implementing what is being taught. In turn, we believe that our well-regarded faculty, including many former and current practitioners in their fields, attracts new students with interest in these fields.

We believe that the quality of our faculty is critical to our success because our most frequent interaction with our students is through our faculty members. We regularly review the performance of our faculty by monitoring the amount of online contact that faculty have with students, reviewing student feedback, and evaluating the learning outcomes achieved by students, among other measures. If we determine that a faculty member is not performing at the level that we require, we work with the faculty member to improve performance, including through assigning the faculty member a mentor. If the faculty member’s performance does not improve, we will no longer allow that faculty member to teach. We do not provide our faculty with tenure.

Partnership At a Distance

We have established proprietary information systems and processes to support what we refer to as Partnership At a Distance™, or PAD. PAD is the patented approach to how we interact with our students. At its center is a dynamic information system enabling us to recognize that every student is unique and to provide individualized support at appropriate times from pre-enrollment through and beyond graduation-including student advising, administrative support, or community networking. By avoiding a one-size-fits-all approach, the system provides us with the flexibility to maintain a highly-engaged partnership with our learners based on their preferences. PAD has allowed us to scale and improve the quality of our academic offerings and student support. We believe PAD enables us to cost-effectively manage and administer monthly starts that exceed 2,200 classes in over 1,000 unique courses and serve approximately 127,000 students taught by over 2,000 faculty members.

We obtained patent protection on PAD in February 2011. American Public University System is pursuing patent protection on several innovations that enhance support student's academic achievement and streamline university operations.

Other Technology Systems and Management

We believe that we have established a functional, secure and reliable technology system to help us fulfill our mission. We continue to invest in technology systems and enhancements to support this system and our growth. Our IT infrastructure consists of two data centers: one in Virginia, and one at a co-location facility in Texas. Our technology environment is managed internally. Student access is provided through redundant data carriers in both data centers.

In 2010, we chose the Sakai Collaboration and Learning Environment ("Sakai CLE"), an open-source Learning Management System, to replace Educator™, our prior Learning Management System as the foundational software for our online classroom. As of 2010, more than 350 educational institutions around the world were reportedly using Sakai CLE to support teaching, learning, research, and collaboration. We completed the implementation of Sakai CLE in the fall of 2011. Shortly after the completion of the migration, we experienced periods of unplanned downtime in our online classroom during periods of peak utilization. We believe that in mid-October 2011 we identified the cause of this downtime and took appropriate steps to mitigate the problem. Since these changes were made, the Sakai CLE has been stable and available to students and faculty with peak utilization in excess of those seen in October, 2011.

Competition

There are more than 4,000 U.S. colleges and universities serving traditional college-age students and adult students. Competition is highly fragmented and varies by geography, program offerings, delivery method, ownership, quality level, and selectivity of admissions. No one institution has a significant share of the total postsecondary market. Within our primary military market, there are more than 1,000 institutions that serve military students and receive tuition assistance funds. Our primary competitors for military students are other institutions offering online bachelor's and master's degrees and traditional colleges and universities located near military installations. We believe that for-profit schools may increasingly be seeking to attract military students for various reasons, including because these schools may see it as helpful in their efforts to comply with the 90/10 Rule, as currently DoD tuition assistance and veterans education benefits do not count towards the 90% limit. See “Regulation of Our Business-Regulation of Title IV Financial Aid Programs- The '90/10 Rule'” below for more information on the 90/10 Rule, including recent proposals to count DoD tuition assistance and veterans education benefits toward the 90% limit.

We compete with not-for-profit public and private two-year and four-year colleges as well as other for-profit schools, particularly those that offer online learning programs. Public and private colleges and universities, as well as other for-profit schools, offer programs similar to those that we offer. Public institutions receive substantial government subsidies, and public and private institutions have access to government and foundation grants, tax-deductible contributions, and other financial resources generally not available to for-profit schools. Accordingly, public and private institutions may have instructional and support resources that are superior to those in the for-profit sector. In addition, some of our competitors, including both traditional colleges and universities and other for-profit schools, have substantially greater name recognition and financial and other resources than we have, which may enable them to compete more effectively for potential students. . We are also continuing to see increasing differentiation between the way in which our competitors are delivering online offerings, which impacts the ability to attract students, facilitate access to education and provide convenience to learners. We believe that in the future many online students will be attracted to institutions in part because of the technology that the institutions offer and the way in which that technology facilitates access to education and learning.

In addition, we face new competition from various emerging non-traditional, credit-bearing and non-credit-bearing education programs provided by proprietary, not-for-profit and public providers, including massively open online courses (MOOCs) offered worldwide without charge by traditional educational institutions and other direct-to-consumer education services, as well as other offerings at low costs to students.

The primary competitive factors for institutions targeting working adult students include: specific degree program offerings; affordability, including tuition and fees and rates of increase; convenience and flexibility, including availability of online courses and the use of education related technology; reputation and academic quality; and marketing effectiveness.

Intellectual Property

We exercise rights associated with patents, copyrights, trademarks, service marks, domain names, agreements, and registrations to protect our intellectual property. Course syllabi are our property, may be used in current and future courses as needed to facilitate instruction, and may be modified to meet evolving course or curriculum requirements. Intellectual property of individual faculty members, such as weekly notes or lectures, remains the property of the faculty member, and is reserved specifically for use only by the faculty member who owns it, unless he/she grants permission for use by others.

We have secured rights to trademarks for various names and terms used in our business, including "American Public University System," "American Military University," "American Public University" "Ready When You Are.", "RESPECTED. AFFORDABLE. ONLINE." and the term “Partnership At a Distance.” We believe these trademarks and brand names are important to how prospective students identify us and are central to a number of our marketing efforts. We also own rights to more than 200 Internet domain names pertaining to APUS, AMU, APU and other unique descriptors. The Patent and Trademark Office issued APUS a patent for our proprietary student information and service system, PAD, in February 2011. American Public University System is also pursuing patents on several innovations that we believe enhance and support student's academic achievement and streamline university operations.

Employees

As of December 31, 2012, we had approximately 2,000 members of faculty and a professional staff of approximately 950 non-faculty employees administering our academic, technology, service, and business operations. Most of our non-faculty employees work in either our headquarters in Charles Town, West Virginia, or in our administrative offices in Manassas, Virginia.

None of our employees are parties to any collective bargaining arrangement. We believe that we have good relationships with our employees.

EXECUTIVE OFFICERS OF AMERICAN PUBLIC EDUCATION, INC.

The table below shows information about our executive officers:

Name	Age	Position
Dr. Wallace E. Boston	58	President, Chief Executive Officer and Director
Harry T. Wilkins	56	Executive Vice President, Chief Financial Officer
Carol S. Gilbert	54	Executive Vice President, Marketing
Dr. Karan Powell	59	Executive Vice President, Provost
Dr. Sharon van Wyk	53	Executive Vice President, Chief Operations Officer
Peter W. Gibbons	60	Senior Vice President, Chief Administrative Officer

Wallace E. Boston, EdD joined us in September 2002 as Chief Financial Officer and, since June 2004, has served as President, Chief Executive Officer, and a member of our board of directors. From August 2001 to April 2002, Dr. Boston served as Chief Financial Officer of Sun Healthcare Group. From July 1998 to May 2001, Dr. Boston served as Chief Operating Officer and then President of NeighborCare Pharmacies. From February 1993 to May 1998, Dr. Boston served as Vice President of Finance and later, Senior Vice President of Acquisitions and Development of Manor Healthcare Corporation, now Manor Care, Inc. From November 1985 to December 1992, Dr. Boston served as Chief Financial Officer of Meridian Healthcare.

Harry T. Wilkins, CPA joined us in February 2007 as Executive Vice President and Chief Financial Officer. From December 2004 to February 2007, Mr. Wilkins served as a member of our board of directors, and from January 2005 to February 2007, he served on the Board of Trustees of American Public University System. Since 2002, Mr. Wilkins has also served as a founding partner of Grandizio, Wilkins, Little & Matthews, LLP, a Baltimore-based CPA firm that specializes in consulting for postsecondary education clients. From May 1992 to August 2001, Mr. Wilkins served as Chief Financial Officer of Strayer Education, Inc. From November 1984 to April 1992, Mr. Wilkins served as Director at Wooden & Benson, an accounting firm specializing in audits of education companies. From January 1979 to November 1984, Mr. Wilkins served as a senior consultant with Deloitte, Haskins and Sells, now Deloitte & Touche.

Carol S. Gilbert joined us in May 2004 as Vice President, Programs and Marketing, was promoted to Senior Vice President, Marketing in January 2005 and was promoted to Executive Vice President, Marketing in January 2009. From August 1998 to October 2003, Ms. Gilbert served as Brand Vice President at Marriott International where she led the strategic planning efforts for the SpringHill Suites' brand and directed business and marketing strategies for the Fairfield Inn brand, including the launch of the Fairfield Inn & Suites brand extension. From April 1996 to October 1997, Ms. Gilbert served as Vice President and Director of Choice Hotels International (formerly owned by Manor Care, Inc.). From February 1991 to April 1996, Ms. Gilbert served as Senior Director, Marketing Strategy of Manor HealthCare Corporation, now Manor Care, Inc.

Karan Powell, Ph.D. joined the Company in April 2004 as Interim Chancellor after serving on the Board of Trustees for two years. From October 2005 to December 2005, Dr. Powell served as the Dean of the School of Business, Management and Graduate studies. From January 2006 to July 2008, Dr. Powell served as Vice President and Academic Dean. In July 2008, Dr. Powell was promoted to Senior Vice President and served as Senior Vice President and Academic Dean until July 2011. Dr. Powell was promoted to Executive Vice President and Provost in August 2011. In 2010, Dr. Powell was invited to be a board member of Higher Education Resource Services (HERS). From 2011 to 2012, Dr. Powell served as Chair of the 40th Anniversary Committee, and in 2012, was appointed as Program Committee Chair. Between 1988 and 2007, Dr. Powell served at Georgetown University in various roles, including

Director of Professional Development in the School of Continuing Education, Director of Organization Development Programs, and Director of IRS Executive Development Program. While at Georgetown University, Dr. Powell also served as an Executive Instructor at the School of Business.

Sharon van Wyk, Ph.D. joined the Company in August 2009 as Executive Vice President, Chief Operations Officer. From March 2006 to April 2008, Dr. van Wyk served as Vice President of Process Excellence, Infrastructure & Online Customer Support at Intuit Inc. From 2001 to 2006, Dr. van Wyk served as Vice President of Process Excellence and New Market Development for Genworth Financial. From 1996 to 2001, Dr. van Wyk served as Manager, Global Risk Management and Six Sigma for GE Capital. From 1988 to 1996, Dr. van Wyk served as Associate Partner, Change Management for Accenture Consulting. Dr. van Wyk was an adjunct professor for the Executive MBA program at the University of Connecticut Business School and possesses several process improvement certifications including Master Black Belt and Six Sigma Instructor.

Peter W. Gibbons joined us in October 2002 as Vice President, Student Services and became Senior Vice President, Chief Operating Officer in January 2005. In May 2007, Mr. Gibbons' title was changed to Senior Vice President, Chief Administrative Officer. From June 2000 to October 2002, Mr. Gibbons served as Vice President, Human Resources for Sitel Corporation. From May 1975 to June 2000, Mr. Gibbons served as a field artillery officer in the United States Army and during his 25 years of service before retiring, Mr. Gibbons commanded soldiers in combat, held senior staff positions at the Department of Army, and taught at the United States Military Academy for three years.

Available Information

Our Company's Internet address is www.americanpubliceducation.com. We make available, free of charge through our website, our annual reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed pursuant to Section 13(a) or 15(d) of the Exchange Act, soon after they are electronically filed with the SEC. In addition to visiting our website, you may read and copy public reports we file with the SEC at the SEC's Public Reference Room at 100 F. Street, NE, Washington DC 20549, or at www.sec.gov . You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

REGULATION OF OUR BUSINESS

We are subject to extensive regulation by (1) state regulatory bodies, (2) accrediting agencies recognized by the U.S. Secretary of Education, (3) the federal government through the U.S. Department of Education and under the Higher Education Act of 1965, as amended, or the Higher Education Act, the Department of Veterans Affairs, and the Department of Defense. The regulations, standards and policies of these agencies cover the vast majority of our operations, including our educational programs, facilities, instructional and administrative staff, administrative procedures, marketing, recruiting, financial operations and financial condition.

As an institution of higher education that grants degrees, diplomas and certificates, we are required to be authorized by appropriate state education authorities. In addition, in certain states as a condition of continued authorization to grant degrees and in order to participate in various federal programs, including tuition assistance programs of the United States Armed Forces, an institution must be accredited by an accrediting agency recognized by the Secretary of Education. Accreditation is a non-governmental process through which an institution submits to qualitative review by an organization of peer institutions, based on the standards of the accrediting agency and the stated aims and purposes of the institution. The Higher Education Act requires accrediting agencies recognized by the Secretary of Education to review and monitor many aspects of an institution's operations and to take appropriate action when the institution fails to comply with the accrediting agency's standards.

Our operations are also subject to regulation due to our participation in federal student financial aid programs under Title IV of the Higher Education Act, which we refer to in this annual report as Title IV programs. Title IV programs, which are administered by the Department of Education, include loans with below market interest rates that are made directly to students by the Department of Education. Title IV programs also include several grant programs for students with the greatest economic need as determined in accordance with the Higher Education Act and Department of Education regulations. To participate in Title IV programs, a school must receive and maintain authorization by the appropriate state education agencies, be accredited by an accrediting agency recognized by the Secretary of Education, and be certified as an eligible institution by the Department of Education.

State Education Licensure

We are currently authorized to offer our programs by the West Virginia Higher Education Policy Commission, the regulatory agency governing postsecondary education in the State of West Virginia, where we are headquartered. We are also authorized to operate as an out-of-state institution by the State Council of Higher Education for Virginia. We are authorized in Virginia because we have administrative offices there, which requires state authorization under Virginia laws.

At present, we enroll students from each of the 50 states, as well as the District of Columbia. We have sought and received confirmation that our operations do not require state licensure or authorization, or we have been notified that we are exempt from licensure or authorization requirements in 32 states. The university and its representatives are licensed or authorized to operate or to conduct activities in the remaining 18 states and the District of Columbia (Alabama, Arkansas, Florida, Georgia, Illinois, Kansas, Louisiana, Maryland, Minnesota, Montana, Nevada, New Mexico, Pennsylvania, Virginia, Washington, West Virginia, Wisconsin and Wyoming). In some cases, state licensure or authorization may impose limitations on certain activities and may impose particular requirements with respect to certain programs. To date, such state-specific limitations and requirements have not had a material effect on our operations.

New program initiatives, such as our teacher education programs, that include “on the ground” components (e.g., student teaching, professional internships, etc.) that may be described as instructional activities, will be viewed by some state regulatory agencies as constituting a physical presence for regulatory purposes. As those programs expand, there is a high probability that we will need to seek formal authorization to operate in some states where historically we were not required to do so. The extent of this expansion in regulatory requirements, and the associated costs, are not known at this time, but we anticipate they may be significant. Furthermore, there may be some states where it takes a significant amount of time to meet the applicable regulatory requirements with respect to a new program initiative, or where we are not able to do so at all.

The increasing popularity and use of the Internet and other online services for the delivery of education has led to the adoption of new laws and regulatory practices in the United States and foreign countries and to new interpretations of existing laws and regulations. For instance, in some states we are required to seek licensure or authorization because our recruiters meet with prospective students in the state. In other states, the state education agency requires licensure or authorization because, for example, we enroll students or employ faculty who reside in the state. We are currently subject to extensive regulations by the states in which we are authorized or licensed to operate. State laws typically establish standards for instruction, qualifications of faculty, administrative procedures, marketing, recruiting, financial operations and other operational matters. State laws and regulations may limit our ability to offer educational programs and to award degrees. Some states may also prescribe financial regulations that are different from those of the Department of Education, and may require the posting of surety bonds. If we fail to comply with state licensing requirements, we may lose our state licensure or authorizations. We believe that under current law the only state authorization or licensure necessary for us to participate in the tuition assistance programs of the United States Armed Forces is our authorization from the West Virginia Higher Education Policy Commission. We believe the same is true for the Title IV programs. As described elsewhere in this annual report, the Department of Education promulgated a regulation to require institutions that offer postsecondary education through distance education to students in a state in which the institution is not physically located or in which it is otherwise subject to the state’s jurisdiction to meet the state’s requirements for postsecondary distance education providers, but a federal court vacated that regulation. Failure to comply with the requirements of the West Virginia Higher Education Policy Commission could result in our losing authorization from the West Virginia Higher Education Policy Commission, eligibility to participate in Title IV programs, or our ability to offer certain programs, any of which may force us to cease operations. Failure to comply with authorization or licensure requirements in other states could restrict our ability to recruit or enroll students in those states.

On October 29, 2010, the Department of Education published final regulations that address certain institutional eligibility issues, including state authorization. The final regulations, which generally took effect July 1, 2011, specify new rules regarding the type of state approvals that are acceptable for an institution to demonstrate that it is authorized by the state where it is located to offer educational programs beyond the secondary level. In addition, in order for an institution to be legally authorized under the final regulations, the relevant state must have a process to review and take appropriate action on complaints concerning postsecondary institutions. If the Department of Education determines that an institution does not have the required state authorization to provide an educational program beyond secondary education in the state in which the institution is physically located, the institution will be ineligible to participate in the Title IV programs. The institution must be able to document to the Department of Education, upon request, the state’s approval.

As described below in “Regulation of Title IV Financial Aid Programs – Distance Learning,” the final regulations also established a new rule related to state authorization and distance education. Under the rule, if an institution offers postsecondary education through distance education to students in a state in which the institution is not physically located or in which it is otherwise subject to the state’s jurisdiction as determined by the state, the institution must meet the state’s requirements for postsecondary distance education providers. In July 2011, the U.S. District Court for the District of Columbia vacated the distance education state authorization rule. The Department of Education has appealed that ruling. See “Regulation of Title IV Financial Aid Programs – Distance Learning,” below, for more information.

Certain states may be required to adopt new laws or regulations to comply with the new state authorization requirements in order to enable institutions in those states to continue to participate in Title IV programs. The new rules related to distance education may also lead some states to adopt new laws and regulatory practices affecting the delivery of distance education to students located in those states. For example, more states may require that online education institutions be licensed in their state despite having no physical location or other presence in that state or may increase requirements applicable to institutions already required to be licensed. In addition, changes in our business or changes in the nature or amount of our contact with or presence within a particular state could lead states that do not currently require us to be licensed or authorized to require such licensure or authorization in the future. In addition to the concerns expressed above, new laws, regulations or interpretations related to doing business over the Internet could increase our cost of doing business and affect our ability to recruit students in particular states, which could, in turn, negatively affect enrollments and revenues and have a material adverse effect on our business.

Accreditation

We received institutional accreditation in 2006 from The Higher Learning Commission of the North Central Association of Colleges and Schools, a regional accrediting agency recognized by the Secretary of Education. In December 2008, The Higher Learning Commission approved expansion of our mission to include liberal arts bachelors degrees. As part of the regularly scheduled evaluation process, we submitted a self-study in January 2011 and underwent an on-site reaccreditation visit in February 2011. In July 2011, the Higher Learning Commission reaffirmed our accreditation status. Our next comprehensive evaluation is scheduled for the 2020-2021 academic year, with an interim progress report on development of university system-wide coordination and improvement of graduate studies due in July 2015. We were also accredited by the Accrediting Commission of the Distance Education and Training Council, or DETC, until April 30, 2012, when we voluntarily withdrew our accreditation.

Accreditation is a non-governmental system for recognizing educational institutions and their programs for student performance, governance, integrity, educational quality, faculty, physical resources, administrative capability and resources, and financial stability. In the United States, this recognition comes primarily through private voluntary associations that accredit institutions or programs of higher education. To be recognized by the Secretary of Education, accrediting agencies must adopt specific standards and procedures for their review of educational institutions or programs. Accrediting agencies establish criteria for accreditation, conduct peer-review evaluations of institutions and programs, and publicly designate those institutions that meet their criteria. Accredited schools are subject to periodic review by accrediting agencies to determine whether such schools maintain the performance, integrity, and quality required for accreditation.

The Higher Learning Commission is the same accrediting agency that accredits such universities as The University of Chicago, Northwestern University, West Virginia University, and other degree-granting public and private colleges and universities in its region (including Arkansas, Arizona, Colorado, Iowa, Illinois, Indiana, Kansas, Michigan, Minnesota, Missouri, North Dakota, Nebraska, Ohio, Oklahoma, New Mexico, South Dakota, West Virginia, Wisconsin and Wyoming).

Accreditation by The Higher Learning Commission is an important attribute of our university. Colleges and universities depend, in part, on accreditation in evaluating transfers of credit and applications to graduate schools. Employers rely on the accredited status of institutions when evaluating a candidate’s credentials, and students and corporate and government sponsors under tuition reimbursement programs look to accreditation for assurance that an institution maintains quality educational standards. Moreover, institutional accreditation by an accrediting agency recognized by the Secretary of Education is necessary for eligibility to participate in tuition assistance programs of the United States Armed Forces and Title IV programs.

In November and December 2009, the Department of Education’s Office of the Inspector General, or OIG, issued reports criticizing three accrediting agencies, including The Higher Learning Commission, for failing to define both program length and credit hours. OIG explained that such failures could result in inflated credit hours, improper designation of full-time student status, and over-awarding of Title IV funds. OIG, in an unusual action, recommended that the Department of Education consider limiting, suspending, or terminating The Higher Learning Commission’s recognition as an accrediting agency for purposes of determining institutional eligibility to participate in Title IV programs. In response, Department of Education staff conducted a special review of The Higher Learning Commission. According to a staff report submitted to the National Advisory Committee on Institutional Quality and Integrity, or NACIQI (the panel charged with advising the Department of Education on whether to recognize accrediting agencies for federal purposes, including Title IV purposes), as a result of the special review, the Department of Education required The Higher Learning Commission to develop a corrective action plan that, among other things, required modification of its substantive change policies and implementation of specific procedures to address changes in ownership. In August 2010, The Higher Learning Commission submitted its response to the

Department of Education's special review.

In December 2010, NACIQI reviewed The Higher Learning Commission's status as a recognized accrediting agency based on the August 2010 response to the special review and a December 2008 interim report, the latter of which responded to a NACIQI review (unrelated to the OIG report) that occurred in 2007. NACIQI voted to continue The Higher Learning Commission's recognition as an accrediting agency but also ordered the agency to submit an additional compliance report in one year. At its December 2011 meeting, NACIQI characterized The Higher Learning Commission's report as "informal" and noted that no vote was to be taken on it.

As explained elsewhere in this annual report, on October 29, 2010, the Department of Education published final regulations that, in part, seek to address OIG's concerns regarding measurement of credit hours. In November 2011, The Higher Learning Commission revised its policies to address the Department of Education's new regulations regarding credit hours. If The Higher Learning Commission were to lose its ability to serve as an accrediting agency for Title IV programs, we may lose our ability to participate in Title IV programs. NACIQI is next scheduled to review the Higher Learning Commission for recognition purposes on June 6-7, 2013. The Higher Learning Commission received further scrutiny in March 2011 during a hearing of the Senate Health Education Labor and Pension, or HELP Committee, focused on accreditation of proprietary institutions.

We believe that regional accreditation has been important in our outreach to military personnel, who we believe are often counseled that regional accreditation is an important consideration when selecting a postsecondary institution. Similarly, obtaining regional accreditation has allowed us to reach additional service members by joining portions of the Servicemembers Opportunity Colleges degree network system, a Department of Defense, or DoD, program that promotes its member institutions to military professionals and that was previously closed to us.

In addition to institutional accreditation, certain specialized accrediting agencies accredit specific programs at our university. Accreditation of a program by a specialized accrediting agency signifies that the program meets the standards of that agency. We have the following specialized accreditations:

Accreditation Council for Business Schools and Programs accredits our Associate of Arts in Business Administration, Bachelor of Business Administration, Bachelor of Arts in Marketing, Master of Business Administration

Commission on Collegiate Nursing Education accredits our Bachelor of Science in Nursing.

In addition, we have obtained professional recognition for our Emergency and Disaster Management program from the Foundation for Higher Education Accreditation, for our Management program from the Society of Human Resources, for our Sports and Health Sciences program by the American Sport Education Program, and for our Child and Family Development program by the National Council on Family Relations.

If we fail to satisfy the standards of these specialized accrediting agencies, we could lose the specialized accreditation for the affected programs, which could result in materially reduced student enrollments in those programs and prevent our students from seeking and obtaining appropriate licensure in their fields.

Nature of Federal, State and Private Financial Support for Postsecondary Education

Our students finance their education through a combination of individual resources, tuition assistance programs of the United States Armed Forces administered by the Department of Defense, or DoD, education benefits administered by the Department of Veterans Affairs, private loans, corporate reimbursement programs, and Title IV programs. Participation in these programs adds to the regulation of our operations.

Tuition Assistance. Service members of the United States Armed Forces are eligible to receive tuition assistance from their branch of service through the Uniform Tuition Assistance Program of the DoD. Service members may use this tuition assistance to pursue postsecondary degrees at postsecondary institutions that are accredited by accrediting agencies that are recognized by the Secretary of Education. For our undergraduate programs we have established tuition rates per semester credit hour that can be 100% covered by DoD tuition assistance funds to undergraduate military students to attend our institution provided that the student does not exceed the annual limits per student. Each branch of the armed forces has established its own rules for DoD tuition assistance programs. Pursuant to these rules, in order for a service member to use his or her tuition assistance funds at American Public University System, or APUS, we need to maintain our state licensure and our regional accreditation and the service member must maintain satisfactory academic progress and must also progress in a timely manner toward completion of his or her degree, among other requirements.

To the extent that tuition assistance programs do not cover the full cost of tuition for service members, service members may also use their benefits under the Montgomery GI Bill or the Post-9/11 Veterans Educational Assistance Act of 2008, or the Post-9/11 GI Bill, as amended, through the GI Bills' Top-Up feature. The U.S. Department of Veterans Affairs, or VA, administers the GI Bills. Pursuant to federal law related to those programs, we are approved for education of veterans and members of the selective reserve and their dependents by the state approving agencies in Virginia and West Virginia. On April 16, 2012, the Department of Veterans Affairs began an on-site program review of our programs. The on-site review was concluded on April 20, 2012, and we have not yet received a formal report from the Department of Veterans Affairs.

If we lost our eligibility to receive tuition assistance from the United States Armed Forces, or if the amount of tuition assistance per service member is reduced, military service members would need to seek alternative funds. While they may be able to use their education benefits under the Montgomery GI Bill or Post-9/11 GI Bill in lieu of DoD tuition assistance funds, we believe that option would not be attractive to these students. As a result, the inability to participate in DoD tuition assistance programs, and any reduction in the funding for DoD tuition assistance programs, could have a material adverse effect on our operations.

In 2010, both the U.S. Congress and DoD increased their focus on DoD tuition assistance that is used for distance education and programs at proprietary institutions. In August 2010, DoD issued proposed regulations that would increase oversight of educational programs offered to active duty service members. Related to this effort, DOD drafted a Memorandum of Understanding, or MOU, to articulate the commitment that institutions providing education services must make in order to receive DOD tuition assistance program funds. On March 15, 2011, DoD circulated the MOU and requested that institutions execute it before January 1, 2012. The draft MOU met with substantial criticism, including from the American Council on Education and 52 U.S. Senators. Despite this, some institutions executed the MOU before the deadline, including us. In response to the criticisms received, DoD revised the regulations and the MOU. The final regulations and MOU, published December 7, 2012 and effective January 7, 2013, require all institutions to sign a MOU, by March 1, 2013. Institutions that have executed a MOU with DOD can retain their current MOU or choose to execute the new MOU. The MOU outlines certain commitments and agreements between the institution and DoD prior to accepting funds under the tuition assistance program.

For example, the MOU requires institutions to participate in the DoD Third Party Assessment to ensure compliance with the MOU and that service members are provided quality voluntary education opportunities that meet their needs. The Third Party Assessment of American Military University was conducted in June 2012 with a revised report submitted in October 2012. The report stated that based on the assessment team's findings, American Military University and American Public University System are in full compliance with the DoD voluntary Education Partnership MOU.

The MOU does not require institutions to become members of the Servicemembers Opportunity Colleges degree network system like us, but all institutions must disclose certain information (such as transfer credit policies) and provide certain resources for Service members (such as designating a person or office to serve as a point of contact for Service members inquiring about academic counseling, financial aid counseling, and student support services). In addition, as part of DoD's efforts to eliminate aggressive marketing aimed at service members, institutions that execute the MOU must not provide any commission, bonus, or other incentive payment based directly or indirectly on securing enrollments or Federal financial aid (including tuition assistance funds) to any persons or entities engaged in any student recruiting, admission activities, or making decisions regarding the award of student financial assistance.

We have executed the MOU originally circulated on March 15, 2011. The DoD may draft and circulate a revised MOU and require that institutions execute the agreement in order to receive DoD tuition assistance program funds. The requirement to enter into a MOU, and the related increased focus by the DoD on relationships and oversight of educational providers, could lead to changes in the nature of our relationships with military bases and educational service officers (including possibly needing to enter into separate installation MOUs and obtain permission to counsel students in person on the installation), which could be adverse in nature. Furthermore, installations may impose additional requirements. For example, at least one installation has banned educational providers from directly counseling potential students on the installation, and additional installations may determine to institute similar bans.

In September 2010, the U.S. House of Representatives Armed Services Committee’s Subcommittee on Oversight and Investigations held a hearing entitled “A Question of Quality and Value: Department of Defense Oversight of Tuition Assistance Used for Distance Learning and For-Profit Colleges.” Both DoD officials and Subcommittee members expressed concern about DoD’s oversight of distance education programs, especially those offered by proprietary institutions. Similarly, in December 2010, the Senate Health Education Labor & Pensions Committee, or HELP Committee, released a report entitled “Benefitting Whom For-Profit Education Companies and the Growth of Military Educational Benefits,” which raised questions about the growing share of DoD tuition assistance and Post-9/11 Veterans Educational Assistance Act of 2008 benefits received by proprietary institutions. In March 2011, the Government Accountability Office, or GAO, published a report entitled “DoD Education Benefits: Increased Oversight of Tuition Assistance Program is Needed,” which offered several recommendations for improving accountability within the tuition assistance program. In September 2011, the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security held a hearing focused on the classification of military education benefits under the “90/10 Rule,” which requires institutions receiving Title IV aid to derive at least 10 percent of their revenue from non-Title IV program sources. Some of the panelists suggested that the classification of military benefits as a non-Title IV program revenue source has led some for-profit institutions to recruit aggressively and sometimes illegally members of the military in order to ensure compliance with the 90/10 Rule. Senator Harkin, Chairman of the Senate Committee on Health, Education, Labor & Pensions spoke on the Senate floor on May 19, 2011 and hosted a press conference on September 22, 2011 to encourage reformation of the 90/10 Rule. See the discussion below under “Regulation of Title IV Financial Aid Programs—The “90/10 Rule” for further discussion of proposed changes to the manner in which the 90/10 Rule is calculated. At this time, we cannot predict the extent to which, or whether, the congressional hearings and report, or advocacy from other organizations or parts of the government, will affect DoD’s current rulemaking or result in legislation or other regulations that would limit or condition the participation of proprietary institutions or distance education programs in DoD tuition assistance programs. In October 2011, the Marine Corps announced, and later rescinded, new tuition assistance rules that cut the maximum benefit for its service members from $4,500 per year to $875 per year and reduced the tuition assistance from $250 per credit hour to $175 per credit hour. Although undergraduate tuition assistance levels have been restored to their prior levels with retroactive benefits to affected service members, the Marine Corps has warned that the current levels of funding are not sustainable. The Marine Corps did reduce graduate level tuition assistance from $350 per credit hour to $250 per credit hour, which is consistent with the current tuition assistance payments from the other military services. We anticipate that the other services will also consider potential changes to the tuition assistance program.

In addition, in October 2011, DoD announced that while it will maintain the current levels of tuition assistance in the near term, it plans to consider changes as part of a holistic review of the military compensation package. We believe modifications to the tuition assistance program may include a reduced per undergraduate credit tuition benefit (currently $250), a decrease in the annual cap (currently $4,500), and/or a requirement that service members pay out-of-pocket for a portion of their tuition, among other possible changes.

If tuition assistance payments are reduced, we believe that most service members would be eligible and able to finance out-of-pocket tuition costs resulting from this shortfall using their "Top Up" benefits under the GI Bills, which allow service members to use a portion of their GI Bill benefits while still on active duty. However, we do not know whether in the long-term service members would be willing to use the Top-Up option, or whether the increased administrative process in using the Top-Up option or covering the shortfall through other funding sources would lead to service members deciding not to enroll or enrolling at a slower rate.

On April 18, 2012, Senators Kay Hagan and Tom Harkin introduced legislation, titled the Protecting Financial Aid for Students and Taxpayers Act, that would prohibit colleges and universities from using funds from Title IV programs, military tuition assistance, veterans education benefits programs, and other federal educational assistance funds to pay for marketing, advertising, and recruiting. On June 14, 2012, the Senate Appropriations Committee reported a 2013 fiscal year appropriations bill that included language from the Protecting Financial Aid for Students and Taxpayers Act bill. Both the appropriations bill and the Protecting Financial Aid for Students and Taxpayers Act bill expired when the 112th Congress ended on January 3, 2013. Were similar legislation introduced in the 113th Congress and became law, it would significantly affect our ability to identify and attract prospective students.

We are unable to estimate the effect of future expected changes to the tuition assistance programs or whether the services would impose other criteria in addition to the level of reimbursement that would impact enrollments from service members. We are also unable to estimate the response that our competitors would take to reduced tuition assistance payments or the willingness of service members to use the Top-Up option available under the veterans education benefits programs. In this regard, our competitors, particularly those with larger student populations or a smaller concentration of students from the military, may be better situated to lower the cost of tuition to service members.

If we are no longer able to receive tuition assistance payments or the tuition assistance program is reduced or eliminated, our enrollments and revenues could be significantly reduced, which would result in a material adverse effect on our results of operations and financial condition.

Title IV Programs. The federal government provides a substantial part of its support for postsecondary education through Title IV programs, in the form of grants and loans to students who can use those funds at any institution that has been certified by the Department of Education to participate in Title IV programs. Title IV program aid is primarily awarded on the basis of financial need, generally defined as the difference between the cost of attending the institution and the amount a student can reasonably contribute to that cost. All recipients of Title IV program funds must maintain satisfactory academic progress and must also progress in a timely manner toward completion of their program of study. In addition, each school must ensure that Title IV program funds are properly accounted for and disbursed in the correct amounts to eligible students.

We were first certified to participate in Title IV programs in September 2006. The Department of Education has approved us to participate in the following Title IV programs (described below): (1) the Federal Family Education Loan Program, or the FFEL Program, (2) William D. Ford Federal Direct Loan Program, or the Direct Loan Program, (3) the Federal Pell Grant program, (4) campus-based programs, and (5) Teacher Education Assistance for College and Higher Education Grant Program, or the TEACH Grant Program.

(1) FFEL Program. On March 30, 2010, President Obama signed the Healthcare and Education Affordability Reconciliation Act of 2010. The legislation, which is known for its overhaul of the healthcare system, eliminated the FFEL Program. Under the FFEL Program, banks and other lending institutions made loans to students and parents of dependent students. As of July 1, 2010, those lending institutions are no longer able to act as lenders of federal student loans, and no new loans could be originated through the FFEL Program. Instead, institutions were required to transition to the Direct Loan Program by July 1, 2010 in order to continue to participate in the major federal loan

programs. This deadline did not affect American Public University System, or APUS, as we had ceased to participate actively in the Direct Loan Program as of December 31, 2009. The FFEL Program includes the Federal Stafford Loan Program, the Federal PLUS Program (which, beginning on July 1, 2006, provided for loans to graduate and professional students as well as parents of dependent undergraduate students), and the Federal Consolidation Loan Program. If a student defaults on a loan, payment is guaranteed by a federally recognized guaranty agency, which is then reimbursed by the Department of Education. Students who demonstrate financial need may qualify for a subsidized Stafford loan. With a subsidized Stafford loan, the federal government will pay the interest on the loan while the student is in school and during any approved periods of deferment, until the student's obligation to repay the loan begins. Unsubsidized Stafford loans are available to students who do not qualify for a subsidized Stafford loan or, in some cases, in addition to a subsidized Stafford loan.

(2) Direct Loan Program. Under the Direct Loan Program, the Department of Education makes loans directly to students rather than guaranteeing loans made by lending institutions. The Direct Loan Program includes the Direct Subsidized Loan, the Direct Unsubsidized Loan, the Direct PLUS Loan (including loans to graduate and professional students), and the Direct Consolidation Loan. The terms and conditions of the Direct Subsidized Loan, the Direct Unsubsidized Loan, the Direct PLUS Loan, and the Direct Consolidation Loan are generally comparable to those of the Federal Stafford Subsidized Loan, the Federal Stafford Unsubsidized Loan, the Federal PLUS Loan, and the Federal Consolidation Loan, respectively. As of June 1, 2009, APUS has originated all new loans for students and their parents through the Direct Loan Program. The Budget Control Act of 2011, signed into law on August 2, 2011, eliminated Direct Subsidized Loans for graduate and professional students, as of July 1, 2012. The terms and conditions of subsidized loans originated prior to July 1, 2012 are unaffected by the law.

(3) Federal Grant Programs. Grants under the Federal Pell Grant program are available to eligible students based on financial need and other factors. An institution that is certified for Pell Grant purposes is considered to be certified for the Academic Competitiveness Grant, or the ACG Grant, Program and National Science and Mathematics Access to Retain Talent Grant, or the SMART Grant, Program, if it has at least one academic program that is ACG Grant/SMART Grant-eligible. However, authorization for the ACG Grant Program and SMART Grant Program expired as of July 1, 2011.

(4) Campus-Based Programs. The “campus-based” Title IV programs include the Federal Supplemental Education Opportunity Grant program, the Federal Work-Study program and the Federal Perkins Loan program. We do not actively participate in any campus-based program.

(5) Teacher Education Assistance for College and Higher Education (TEACH) Grant Program. The TEACH Grant Program provides up to $4,000 a year in grant assistance to undergraduate, post-baccalaureate, and graduate students who agree to serve for at least four years as full-time “highly qualified” teachers in high-need fields in public or not-for-profit private elementary or secondary schools that serve students from low-income families.

In August 2011, President Obama signed the Budget Control Act of 2011, which provided for both an increase in the federal government's borrowing authority and reductions in spending. The Budget Control Act of 2011 eliminated the in-school interest exemption for graduate student loans beginning July 1, 2012. The cost of borrowing will increase for graduate students who defer payment of interest while enrolled, which could adversely impact our enrollments. Also, under the Budget Control Act of 2011, Congress must develop legislation to achieve further deficit reduction, and the outcome of this process is uncertain. Unless Congress takes further action, automatic, across-the-board reductions in federal spending (also known as “sequestration”) will begin on March 1, 2013. The Budget Control Act of 2011 and the Statutory Pay-As-You-Go Act of 2010 each provide for the possibility of sequestration as a budgetary enforcement tool. On January 2, 2013, Congress enacted the American Taxpayer Relief Act of 2012, which delayed potential sequestration under the Budget Control Act of 2011 until March 1, 2013. If sequestration is triggered by either the Budget Control Act of 2011 or the Statutory Pay-As-You-Go Act of 2010, funding for Title IV programs would be affected. Pell Grants would be exempt from cuts through fiscal year 2013, but could be subject to sequestration in fiscal year 2014 and beyond. Most other federal student aid programs would be subject to across-the-board cuts to discretionary programs at a rate of approximately 8.2%. Origination fees for Stafford loans and PLUS loans would increase approximately 7.6%, to approximately 1.076% and 4.034% of the total loan, respectively. Cuts to the Department of Education's Federal Student Aid Administration budget could lead to delays in student eligibility determinations and delays in processing and origination of federal student loans. The House Committee on the Budget released a report in January 2013 stating that programs administered by the Department of Veterans Affairs will be exempt from sequestration, however, there are no such assurances with respect to the tuition assistance programs of the Department of Defense. Although the Pell Grant program and programs administered by the Department of Veterans Affairs currently are exempt from the sequestration process, other federal programs and services that could affect our business could be included. Any action by Congress that significantly reduces Title IV program funding, whether through across-the-board funding cuts or otherwise, or materially impacts our eligibility or our students eligibility to participate in Title IV programs would have a material adverse effect on our enrollment, financial condition, results of operations, and cash flows.

On September 17, 2012, the Department of Education updated waivers and modifications of provisions governing the Title IV programs for the benefit of individuals who are performing qualifying military service (or individuals who are affected by a disaster, war or other military operation or national emergency) under the authority of the Higher Education Relief Opportunities for Students Act of 2003, or HEROES Act. The Department of Education acted to bring provisions into compliance with statutes and regulations enacted and promulgated after these provisions were originally published.

Private Lenders. In certain circumstances, our students may access alternative loan programs. Alternative loans are intended to cover the difference between what the student receives from all financial aid sources and the full cost of the student's education. Students can apply to a number of different lenders for this funding at current market interest rates.

Since its creation in 2011, the Consumer Financial Protection Bureau, or CFPB, has taken steps to regulate student loans. In 2012, it issued two reports identifying concerns about the student loan market and published nearly 2,000 complaints from borrowers of private student loans. In December 2012, CFPB issued procedures describing how it will conduct examinations of financial institutions that make educational loans to determine their compliance with existing laws and regulations. The procedures are designed to assess whether a lender engages in accurate and non-discriminatory advertising and marketing, provides proper and clear disclosures, supplies accurate account information to borrowers, and has adequate channels to receive customer questions and complaints. In January 2013, CFPB encouraged institutions of higher education, students, and others to provide information by March 18, 2013 about the financial products and services currently offered to students, and comments on how current and future arrangements between institutions of higher education and financial institutions could be structured in order to promote positive financial decision-making among consumers.

Congress is considering bills that would affect private loans to students. On January 23, 2013, Senator Durbin introduced the Know Before You Owe Private Student Loan Act of 2013, which would require institutions to certify to a private loan lender a student's cost of attendance and estimated federal financial assistance before a loan may be issued to such student. The Act would also require institutions to counsel students about their loan options, including discussion of differences between federal loans and private loans. Private loan lenders would be required to provide students with quarterly account updates on the balance and interest accrued. On January 23, 2013, Senator Durbin also introduced the Fairness for Struggling Students Act of 2013, which would allow private student loans to be dischargeable in bankruptcy. We do not know what steps Congress may take in response to these actions and whether such actions (if any) will have an adverse effect on our business or results of operations.

Additional Sources of Financial Support. In addition to the programs stated above, eligible students may participate in several other financial aid programs or receive support from other governmental and private sources. For example, some of our students who are veterans use their benefits under the GI Bills to cover their tuition. Certain of our students are also eligible to receive funds from other education assistance programs administered by the Department of Veterans Affairs. Pursuant to federal law providing benefits for veterans and reservists, we are approved for education of veterans and members of the selective reserve and their dependents by the state approving agencies in Virginia and West Virginia. Finally, some of our students finance their own education or receive full or partial tuition reimbursement from their employers.

The Post-9/11 GI Bill expanded education benefits for veterans who have served on active duty since September 11, 2001, including reservists and members of the National Guard. As originally passed, the Post-9/11 GI Bill provided that eligible veterans could receive benefits for tuition purposes up to the cost of in-state tuition at the most expensive public institution of higher education in the state where the veteran was enrolled. In addition, veterans who were enrolled in classroom-based programs or “blended programs” (programs that combine classroom learning and distance learning) could receive monthly housing stipends, while veterans enrolled in wholly distance-based programs were not entitled to a monthly housing stipend. The provisions regarding education benefits for post-9/11 veterans took effect August 1, 2009. The Post-9/11 GI Bill also increased the amount of education benefits available to eligible veterans under pre-existing Montgomery GI Bill. The legislation also authorized expansion of service members’ ability to transfer veterans’ education benefits to family members.

On January 4, 2011, President Obama signed the Post-9/11 Veterans Educational Assistance Improvements Act of 2010, or Improvements Act, which amends the Post-9/11 GI Bill in several pertinent respects. The Improvements Act alters the way benefits related to tuition and fees are calculated. For nonpublic U.S. institutions, the Improvements Act bases the benefits related to tuition and fees on the net cost to the student (after accounting for state and federal aid, scholarships, institutional aid, fee waivers, and similar assistance) rather than the charges established by the institution, and it replaces the state-dependent benefit cap with a single national cap of $17,500. In addition, veterans pursuing a program of education solely through distance learning on a more than half-time basis are eligible to receive up to 50% of the national average of the basic housing allowance available to service members who are at military pay grade E-5 and have dependents. Most Improvements Act changes took effect on August 1 or October 1, 2011, though changes to rules regarding eligibility for benefits were effective immediately or retroactively to the effective date of the Post-9/11 GI Bill. The Improvements Act did not change the Post-9/11 GI Bill’s provision that allows veterans to receive up to $1,000 per academic year for books, supplies, equipment, and other education costs.

Regulation of Title IV Financial Aid Programs

To be eligible to participate in Title IV programs, an institution must comply with specific standards and procedures set forth in the Higher Education Act and the regulations issued thereunder by the Department of Education. An institution must, among other things, be licensed or authorized to offer its educational programs by the state within which it is physically located (in our case, West Virginia) and maintain institutional accreditation by a recognized accrediting agency. In May 2008, we were fully recertified to participate in Title IV programs after having completed an initial period of participation during which we were provisionally certified. In August 2008, we were deemed to have undergone a change in ownership and control requiring review by the Department of Education in order to reestablish our eligibility and continue participation in Title IV programs. In connection with this review, we submitted to the Department of Education a change in ownership application that included the submission of required documentation, including a letter from The Higher Learning Commission indicating that it had approved the change. On October 2, 2008, we received a letter from the Department of Education approving the change in ownership and control and granting us provisional certification until September 30, 2010. On July 2, 2010, we received a letter from the Department of Education notifying us that we are fully recertified to participate in Title IV programs through December 31, 2014, and that we are no longer provisionally certified. See “Eligibility and Certification Procedure” and “Regulatory Actions and Restrictions on Operations” below for more information.

The substantial amount of federal funds disbursed through Title IV programs, the large number of students and institutions participating in these programs and allegations of fraud and abuse by certain for-profit institutions have caused Congress to initiate a congressional investigation into for-profit institutions and to require the Department of Education to exercise considerable regulatory oversight over for-profit institutions of higher learning. Accrediting agencies and state education agencies also have responsibilities for overseeing compliance of institutions with Title IV program requirements. As a result, our institution is subject to extensive oversight and review. In 2011, extensive new and amended Department of Education regulations went into effect. The Department of Education has initiated a new rulemaking to address the federal student loan programs and teacher preparation programs, and Congress recently enacted legislation that may lead to new Department of Education regulations. The Department periodically revises its regulations and changes its interpretations of existing laws and regulations. For all these reasons, we cannot predict with certainty how the Title IV program requirements will be applied in all circumstances. See “Recent Congressional Action,” “Recent Regulatory Changes,” and “Pending Regulatory Changes” below for more information.

Significant factors relating to Title IV programs that could adversely affect us include the following:

Recent Congressional Action. As explained below, in recent years, Congress has enacted a number of substantial changes to Title IV programs, both in terms of the structure of the programs themselves and the requirements imposed upon institutions participating in those programs. Congress has also initiated an examination of the for-profit postsecondary education sector that could result in legislation or additional regulations that could materially affect our business. In addition, on an annual basis, Congress makes budgetary and appropriations decisions that could materially affect our business.

Congress reauthorizes the Higher Education Act approximately every five to six years. On August 14, 2008, the Higher Education Opportunity Act, or HEOA, the most recent reauthorization of the Higher Education Act, was enacted. HEOA provisions are effective upon enactment, unless otherwise specified in the law. Selected HEOA provisions are described in relevant parts of this annual report. HEOA includes numerous new and revised requirements for higher education institutions and thus increases substantially regulatory burdens imposed on such institutions under the Higher Education Act.

During 2009, the Department of Education developed regulations to implement HEOA changes to the Higher Education Act. The Department of Education published final regulations in October 2009. Those regulations took effect July 1, 2010. If our efforts to comply with HEOA’s provisions are inconsistent with how the Department of Education interprets those provisions, we may be found to be in noncompliance with such provisions and the Department of Education could impose monetary penalties, place limitations on our operations, and/or condition or terminate our eligibility to receive Title IV program funds.

On March 30, 2010, President Obama signed the Healthcare and Education Affordability Reconciliation Act of 2010, or Reconciliation Act. The Reconciliation Act, which is widely known for its overhaul of the healthcare system, amended the Higher Education Act to eliminate the FFEL Program. As of July 1, 2010, private banks could no longer act as lenders of federal student loans, and no new Stafford, PLUS, or consolidation loans could be disbursed through the FFEL Program. Instead, institutions were required to transition to the Direct Loan Program by July 1, 2010 in order to continue to participate in the major federal loan programs. This deadline did not affect APUS, as we had ceased to participate actively in the Direct Loan Program as of December 31, 2009.

As discussed above, on August 2, 2011, President Obama signed The Budget Control Act of 2011, which among other things, eliminated Direct Subsidized Loans for graduate and professional students, as of July 1, 2012. The terms and conditions of subsidized loans originated prior to July 1, 2012 are unaffected by the law.

On December 23, 2011, President Obama signed the Consolidated Appropriations Act of 2012. The law includes a number of provisions that significantly affect Title IV programs. For example, it reduces the income threshold at which students are assigned “an automatic zero expected family contribution” for purposes of awarding financial aid for the 2012-2013 award year. Under the Act, students who do not have a high school diploma or a recognized equivalent (e.g., GED) or do not meet an applicable home school requirement and who first enroll in a program of study on or after July 1, 2012 will not be eligible to receive Title IV aid. The Act also set the maximum Pell Grant award for 2012-2013 at $5,500 and made several changes to the Federal Pell Grant program, including establishing that, beginning with the 2012-2013 award year, students may not receive a Pell Grant if they are not eligible for at least ten percent of the maximum Pell Grant award for the academic year and reducing the duration of a student’s Pell Grant eligibility to 12 semesters from 18 semesters. The Act temporarily eliminates the interest subsidy provided for Direct Subsidized Loans during the six-month grace period immediately following termination of enrollment.

On January 10, 2013 President Obama signed the Improving Transparency of Education Opportunities for Veterans Act. This law is designed to help GI Bill beneficiaries choose the school that best meets their educational needs by mandating that these beneficiaries receive certain information about available educational resources. It requires the Department of Veterans Affairs to establish a comprehensive policy for providing information to veterans and members of the Armed Forces regarding higher education and training programs, including a centralized mechanism to publish feedback from students and state approving agencies about each institution's quality of instruction, recruiting practices, and placement of graduates. The law permits institutions to verify the feedback and address any issues that they might identify with such feedback before it is published.

We cannot predict with certainty whether or when Congress might act to amend further the Higher Education Act. For most programs subject to the Act, the Act provides funding authorization for programs until the end of fiscal 2014, and the General Education Provisions Act will automatically extend these authorizations to fiscal year 2015. We note, however, that the last time the Higher Education Act was renewed, Congress did not succeed in doing so until it was five years past its statutory renewal date. Given the significant budgetary and other issues facing the current Congress, as well as the political climate, there is no reason to believe that the Higher Education Act will be renewed during the 113th Congress. The elimination of additional Title IV programs, material changes in the requirements for participation in such programs, or the substitution of materially different programs could increase our costs of compliance and could reduce the ability of certain students to finance their education at our institution. Beginning in June 2010, the Senate HELP Committee held a series of hearings related to for-profit postsecondary education institutions. Also in June, the House Education and Labor Committee held a hearing to examine accreditors' standards and procedures pertinent to higher education institutions' policies on credit hours and program length, including those of The Higher Learning Commission. During each of the hearings, some committee members raised concerns about the growing proportion of federal student financial aid going to for-profit schools. On August 4, 2010, the Senate HELP Committee held a hearing to examine the student recruitment experience at for-profit postsecondary education institutions, and on September 30, 2010, the Senate HELP Committee held a hearing on the federal investment in for-profit education and the resulting student outcomes. The Senate HELP Committee held additional hearings in 2011. On March 10, 2011, the Committee held a hearing to present a case study of another for-profit postsecondary education institution, its educational services, and the role of accreditor, state, and federal oversight. On June 7, 2011, the Senate HELP Committee held a hearing on financial outcomes of students at for-profit colleges. At a number of hearings, committee members have expressed concern about the amount of student loan debt taken on by students at for-profit institutions. On July 11, 2011, the HELP Committee hosted a roundtable discussion of policy solutions for improving for-profit postsecondary education.

On June 21, 2010, the chairmen of the House and Senate education committees, along with other members of Congress, asked the General Accountability Office, or GAO to review various aspects of the for profit education sector, including recruitment practices, educational quality, student outcomes, the sufficiency of integrity safeguards against waste, fraud and abuse in Title IV programs, and the degree to which for-profit schools' revenue is comprised of Title IV and other federal funding sources. On August 4, 2010, the GAO released a report based on a three-month undercover investigation of recruiting practices at for-profit schools. The report concluded that employees at a non-random sample of 15 for-profit schools (which did not include APUS) made deceptive statements to students about accreditation, graduation rates, job placement, program costs, or financial aid. On November 30, 2010, the GAO issued a revised version of that report that corrected or further explained a number of the instances of allegedly deceptive conduct. The GAO reported that the revisions were made because additional information came to light and explained that the revisions do not alter any of its findings or the overall message of the report. On October 31, 2011, the GAO released a second report following additional undercover investigation related to enrollment, cost, financial aid, course structure, substandard student performance, withdrawal, and exit counseling. The report concluded that while some of the 15 unidentified for-profit schools investigated appeared to follow existing policies, others did not. Although the report identified a number of deficiencies in specific instances, it made no recommendations. On December 7, 2011, the GAO released a report that attempted to compare the quality of education provided by for-profit, not-for-profit, and public institutions based upon multiple outcome measures including graduation rates, pass rates on licensing exams, employment outcomes, and student loan default rates. The report found that students at for-profit institutions had higher graduation rates for certificate programs, similar graduation rates for associate's degree programs, and lower graduation rates for bachelor's degree programs than students at not-for-profit and public institutions. It also found that a higher proportion of bachelor's degree recipients from for-profit institutions took out loans than did degree recipients from other institutions and that some evidence exists that students at for-profit institutions default on their student loans at higher rates. On nine of the 10 licensing exams reviewed, graduates of for-profit institutions had lower pass rates than students from not-for-profit and public institutions.

On August 5, 2010, we were among 30 for-profit schools to receive a letter from Senator Tom Harkin, Chairman of the HELP Committee, requesting documents as part of a review of matters related to for-profit postsecondary education institutions whose students receive federal student financial aid. The document request sought information on loan default rates; institutional spending; program costs; student outcomes, such as completion and placement rates; and recruiting practices, such as use of third-party lead generators. During a September 30, 2010 HELP Committee hearing, Senator Harkin released a report entitled “The Return on Federal Investment in For-Profit Education: Debt Without a Diploma.” The report, which was based in part on the analysis of documents received from some of the for-profit schools without identifying any specific institutions, focused on for-profit schools’ increasing profits, the growing proportion of federal funds flowing to for-profit schools, and the high debt levels amassed by some for-profit school students. On July 30, 2012, the HELP Committee issued a final report entitled “For Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success,” which summarized the results of its investigations. While the report acknowledged that for-profit education institutions have a role to play in American society given insufficient capacity at not-for-profit and public education institutions, it made specific policy suggestions for future legislation that could affect proprietary institutions, including:

- tying access to federal aid to meeting minimum student outcome thresholds;
- prohibiting institutions from funding marketing, advertising and recruiting activities with federal financial aid dollars;
- improving cohort default rate tracking by expanding the default reporting rate period beyond three years;
- requiring that proprietary colleges receive at least 15 percent of revenues from sources other than federal funds; and
- using criteria beyond accreditation and state authorization for determining institutions' access to federal financial aid.

The report was not adopted by the full Committee, and the minority Members released their own report criticizing the majority's investigation in many aspects, including that it did not include a review of all institutions of higher education. Despite the fact that the full Committee did not adopt the report, Congress may consider the report as it begins the process of reauthorizing the Higher Education Act.

We incurred significant legal and other costs in responding to the congressional inquiry. We cannot predict the extent to which, or whether, Congress’s examination could lead to new legislation or Department of Education regulations that would limit or condition participation of for-profit schools in Title IV programs.

In addition, on an annual basis, Congress reviews and determines appropriations for Title IV programs through the budget and appropriations process. A reduction in federal funding levels of such programs could reduce the ability of certain students to finance their education. These changes, in turn, could lead to lower enrollments, require us to increase our reliance upon alternative sources of student financial aid and impact our growth plans. The loss of or a significant reduction in Title IV program funds available to our students could reduce our enrollment and revenue and possibly have a material adverse effect on our business and plans for growth. In addition, the legislation and implementing regulations applicable to our operations have been subject to frequent revisions, many of which have increased the level of scrutiny to which for-profit postsecondary education institutions are subjected and have raised applicable standards. If we were not to continue to comply with legislation and implementing regulations applicable to our operations, such noncompliance might impair our ability to participate in Title IV programs, offer educational programs or continue to operate. Certain of the statutory and regulatory requirements applicable to us are described below.

Recent Regulatory Changes. In 2009-2010, the Department of Education conducted negotiated rulemaking to develop regulations to address matters related to the integrity of Title IV programs. Negotiated rulemaking is a process required by the Higher Education Act to allow affected constituencies to share with the Department of Education their views on regulatory issues before the Department issues proposed regulations. The negotiated rulemaking addressed, among other topics, institutional eligibility issues (such as state authorization for postsecondary education institutions), definitional issues (such as the definition of “gainful employment in a recognized occupation” and “credit hour” for certain eligibility and other purposes), student eligibility issues (including the validity of high school diplomas), and other Title IV provisions (such as incentive payments and misrepresentation). The negotiated rulemaking committee failed to reach consensus on the entire regulatory package that was the subject of negotiation. Accordingly, the Department of Education was not required to use any language that was developed during negotiations, including language on which the negotiators reached tentative agreement.

On June 18, 2010, the Department of Education issued a notice of proposed rulemaking, or NPRM, with respect to many of the issues subject to the negotiated rulemaking process, other than the metrics for determining compliance with the gainful employment requirement. On July 26, 2010, the Department of Education issued an NPRM regarding various elements of the gainful employment requirement, specifically the information that must be disclosed to prospective students, the information that must be reported to the Department of Education, and the metrics that will be used to determine compliance with the requirement. On October 29, 2010, the Department of Education issued final regulations for those proposed in the June 18 NPRM, as well as final regulations regarding gainful employment programs, including disclosure and reporting requirements for programs that must prepare for gainful employment and procedures under which an institution must apply for approval to offer an educational program that prepares students for gainful employment in a recognized occupation. The October 29 final regulations were effective July 1, 2011. On June 13, 2011, the Department of Education published final regulations on metrics for gainful employment programs effective July 1, 2012.

On January 21, 2011, the Association of Private Sector Colleges and Universities, or APSCU, filed a lawsuit in the U.S. District Court for the District of Columbia challenging the October 29, 2010 final regulations on program integrity related to the state authorization, incentive compensation, and misrepresentation requirements on the grounds that such regulations exceeded the Department of Education's statutory and constitutional authority. The District Court vacated the section of the regulations that requires an institution that offers postsecondary education through distance education to students in a state in which the institution is not physically located or in which it is otherwise subject to the state's jurisdiction to meet the state's requirements for postsecondary distance education providers. The District Court let stand the remainder of the state authorization regulation as well as the regulations related to incentive compensation and misrepresentation. On June 5, 2012, the U.S. Court of Appeals for the District of Columbia upheld the lower court's ruling vacating the state authorization of online programs requirement and vacated portions of the substantial misrepresentation regulation that it found to exceed the Higher Education Act's limits. On July 27, 2012, the Department of Education issued a Dear Colleague Letter cautioning education institutions to remain in compliance with all applicable state laws and regulations related to distance education. The Department of Education has not announced its next steps, but it may engage in the future in a negotiated rulemaking to address distance education and state authorization.

Gainful Employment. To be eligible for Title IV funding, certain academic programs, including all degree and non-degree programs at proprietary institutions of higher education (other than, in limited circumstances that apply to APUS, certain liberal arts programs), must prepare students for gainful employment in a recognized occupation. The disclosure and reporting requirements and metrics for compliance are described below.

(a) Disclosure: Beginning July 1, 2011, for the most recently completed award year, all institutions must disclose to prospective students, with respect to each of their gainful employment programs, occupations that the program prepares students to enter, total cost of the program, on-time graduation rate, job placement rate, if applicable, and the median loan debt of program completers. Institutions must update such information within a reasonable period of time after the information becomes available.

(b) Reporting: With respect to each gainful employment program, institutions must annually report to the Department of Education information regarding each enrolled student, including the amount of debt incurred under private loans and institutional finance plans, matriculation information, and end of year enrollment information. Information related to award year 2010-2011 (the most recently completed award year) as well as prior award years (2006-07 through 2009-2010) must have been reported by November 15, 2011. Institutions must report information for subsequent award years no earlier than September 30 of the calendar year in which the award year ends but no later than the date established by the Department of Education through notice in the Federal Register. If an institution is unable to supply all or some of the required information, it must provide an explanation to the Department of Education.

(c) Metrics: An academic program is considered to prepare students for gainful employment if it meets at least one of the following three metrics:

1. Annual loan repayment rate. This metric measures the rate at which the federal student loan debt incurred by the applicable cohort of borrowers to attend the program is being repaid. Generally, the annual loan repayment rate for an academic program is the percentage of federal student loans incurred to fund the costs of a program that are in satisfactory repayment three to four years after entering repayment. Rates are calculated on a federal fiscal year basis. The repayment rate must be at least 35%. Institutions have an opportunity to challenge the repayment rate data.

2. Discretionary income ratio. This metric compares (i) the annual repayment required on student loan debt attributable to tuition and fees by students who completed the program to (ii) their discretionary income. The median annual loan payment amount (calculated as described below) for the applicable cohort of students may not be higher

than 30% of the greater of their average or median discretionary income. Discretionary income is the annual earnings of a program completer minus 150% of the U.S. Department of Health and Human Services, or HHS, poverty guideline for a single person in the continental United States. The debt-to-discretionary income ratio examines students in their third or fourth year after graduation, calculated on a federal fiscal year basis. The earnings used will generally be based on information received by the U.S. Department of Education from the Social Security Administration, subject under certain circumstances to the use of the 25th percentile of Bureau of Labor Statistics income data for specific "standard of occupational classification" codes for fiscal years 2012 through 2014.

3. Annual earnings ratio. This metric compares (i) the annual repayment required on student loan debt attributable to tuition and fees by students who completed the program to (ii) their actual annual earnings. The median annual loan payment amount for the applicable cohort of students may not be greater than 12% of the greater of their average or median annual earnings. The debt-to-actual earnings ratio examines students in their third or fourth year after graduation, calculated on a federal fiscal year basis. The earnings used will generally be based on information received by the U.S. Department of Education from the Social Security Administration, subject under certain circumstances to the use of the 25th percentile of Bureau of Labor Statistics income data for specific "standard of occupational classification" codes for fiscal years 2012 through 2014.

Starting in 2012, the Department of Education began to calculate the three metrics for each gainful employment program for each federal fiscal year, running from October 1 to September 30. An academic program that satisfied any one metric is considered to be preparing students for gainful employment. If an academic program fails all three metrics, the institution will have the opportunity to improve the performance of that program. After one failure, the institution must disclose to enrolled and prospective students the amount by which the program missed minimal acceptable performance and the program's plan for improvement. After two failures within three years, the institution must inform prospective and current students in the failing program that their debt may be unaffordable, that the program may lose eligibility, and what transfer options exist. After three failures within four years, the academic program loses eligibility to participate in Title IV programs for at least three years, although the program may be continued without federal student aid. These gainful employment standards are effective beginning July 1, 2012, and the Department of Education will begin calculating debt measures for fiscal year 2012 (October 1, 2011 to September 30, 2012). Institutions will be notified of failing programs based on that data. The earliest a program could lose eligibility under the gainful employment rule will be fiscal year 2015, based on its 2012, 2013 and 2014 performance under the above metrics. Eligibility losses in 2015 will be limited to the lowest five percent of all programs among all institutions. On June 21, 2012, the Department of Education released data to institutions showing the calculation of gainful employment metrics based on data reported for federal fiscal years 2007 and 2008. The Department of Education released this information to the public on June 26, 2012. The released rates were for informational purposes only and are available from the Department of Education's website.

In addition, final regulations issued October 29, 2010 require institutions to notify the Department of Education at least 90 days before the commencement of a new educational program that prepares students for gainful employment in recognized occupations if the program has a Classification of Instructional Programs, or CIP, code under the taxonomy of instructional program classifications and descriptions developed by the National Center for Education Statistics that is different from any other program offered by the institution, the program has the same CIP code as another program offered by the institution but leads to a different degree or certificate, or the institution's accrediting agency determines the program to be an additional program. This notification must include information on the market need for the program, any performed wage analysis, any external program review and approval, and a demonstration of accreditation. The institution may proceed to offer the program, unless the Department alerts the institution at least 30 days before the first day of class that approval is required because the Department has identified concerns about the institution's financial responsibility or capacity, the institution's process or decision to add the new program, or certain other issues. If the Department of Education denies approval, the institution may not provide Title IV aid to students enrolled in that program. If the Department of Education denies approval, the institution may respond to the Department's stated reasons for denial and request reconsideration. The final regulations were generally effective July 1, 2011. According to the Department, these notice and application procedures for new programs were intended to remain in place until the Department issued a new rule to implement performance-based standards for approving new programs using gainful employment measures. On September 27, 2011 the Department of Education issued an NPRM in which it proposed, among other changes, to define a smaller group of gainful employment programs for which an institution must obtain approval from the Department, including only programs that are the same as or substantially similar to programs performing poorly under the gainful employment metrics. The September 27 NPRM also included some additional procedural clarifications.

If our efforts to comply with the new and impending regulations are inconsistent with how the Department of Education interprets those regulations, either due to insufficient time to implement the necessary changes, uncertainty about the meaning of the rules, or otherwise, we may be found to be in noncompliance with such regulations and the Department of Education could impose monetary penalties, place limitations on our operations, and/or condition or terminate our eligibility to receive Title IV program funds. However, we cannot predict with certainty the effect the new and impending regulatory provisions will have on our business.

On July 20, 2011, APSCU filed a lawsuit in the U.S. District Court for the District of Columbia challenging the Department of Education's October 29, 2010 and June 13, 2011 final regulations on gainful employment. The lawsuit challenges the reporting and disclosure regulations, the metrics used to calculate gainful employment, and the new program approval regulations. APSCU alleges that the regulations represent overreaching by the Department of Education, conflict with congressional intent, and were developed through a flawed administrative process that violated the Administrative Procedure Act, the Higher Education Act, and the Constitution. On June 30, 2012, the U.S. District Court for the District of Columbia struck down the debt measures and certain related requirements; the court ruled one day before the debt measure regulations would have gone into effect. The court held that the Department of Education interpreted reasonably its statutory authority when it promulgated the gainful employment regulations but arbitrarily chose the debt repayment rate percentage. The court's ruling did not affect the gainful employment regulations related to certain disclosures to prospective students, such as on-time graduation rates and tuition and fees. The Department of Education required institutions to make such disclosures by July 1, 2011, and to update such disclosures for the 2011-2012 award year by January 31, 2013.

On July 6, 2012, the U.S. Department of Education issued an announcement acknowledging that the Court had vacated the debt measures that would have gone into effect on July 1, 2012. The announcement stated that institutions are not required to comply with related regulations addressing reporting requirements and adding new gainful employment programs. Pending a final ruling in this case, the Department of Education has advised schools to follow the rules on additional programs that immediately preceded the gainful employment rules. The version once again in effect provides that approval of new programs is not required if the additional program prepares students for gainful employment in the same or related occupation as an educational program that has previously been designated as eligible and is at least eight semester hours, twelve quarter hours, or 600 clock hours.

On July 30, 2012, Department of Education filed a motion with the U.S. District Court for the District of Columbia to alter or amend the judgment. The Department of Education argued in its motion that even though it would not be permitted to sanction education institutions for failure to meet the debt measure thresholds, (i) education institutions should disclose information to the Department of Education that will allow the Department of Education to calculate the debt measures and (ii) education institutions should include the results of the debt measure calculations in their disclosures to prospective students. On September 24, 2012, the U.S. District Court for the District of Columbia requested a supplemental briefing by the parties addressing, in brief, (i) the scope of the Department of Education's statutory authorization to maintain a database of information about student borrowers and (ii) the authority on which the Department of Education relied to argue that it could require education institutions to provide information to the Department of Education for purposes of calculating the debt measures and then require education institutions to disclose the results of those debt measure calculations. The parties filed supplemental briefs in November 2012, and the U.S. District Court for the District of Columbia is expected to render a decision in 2013. The Department of Education could impose regulations in the future that would penalize us (including making us ineligible to receive Title IV funds) if our students fail to achieve certain debt repayment, debt-to-income, or debt-to-discretionary income ratios.

Eligibility and Certification Procedures. Each institution must apply periodically to the Department of Education for continued certification to participate in Title IV programs. Such recertification generally is required every six years, but may be required earlier, including when an institution undergoes a change of control. An institution may come under the Department of Education’s review when it expands its activities in certain ways, such as opening an additional location, adding a new program, or, in certain cases, when it modifies academic credentials that it offers. The Department of Education may place an institution on provisional certification status if it finds that the institution does not fully satisfy all of the eligibility and certification standards and in certain other circumstances, such as when an institution is certified for the first time or undergoes a change in ownership resulting in a change in control. During the period of provisional certification, the institution must comply with any additional conditions included in its program participation agreement. In addition, the Department of Education may more closely review an institution that is provisionally certified if it applies for approval to open a new location, add an educational program, acquire another school or make any other significant change. If the Department of Education determines that a provisionally certified institution is unable to meet its responsibilities under its program participation agreement, it may seek to revoke the institution’s certification to participate in Title IV programs with fewer due process protections for the institution than if it were fully certified. Students attending provisionally certified institutions remain eligible to receive Title IV program funds.

Distance Learning. We offer all of our existing degree, diploma and certificate programs from our headquarters in Charles Town, West Virginia via internet-based telecommunications. Under HEOA, an accreditor that evaluates institutions offering distance education must require such institutions to have processes through which the institution establishes that a student who registers for a distance education program is the same student who participates in and receives credit for the program.

Under the final Department of Education regulations published on October 29, 2010, if an institution offers postsecondary education through distance education to students in a state in which the institution is not physically located or in which it is otherwise subject to state jurisdiction as determined by the state, the institution must meet any state requirements for it to offer legally postsecondary distance education in that state. The institution must be able to document state approval for distance education if requested by the Department of Education. In addition, states must have a process to review and take appropriate action on complaints concerning postsecondary institutions. These new rules were to become effective July 1, 2011, although the Department of Education indicated in an April 20, 2011 guidance letter that it would not initiate any action to establish repayment liabilities or limit student eligibility for distance education activities undertaken before July 1, 2014, provided the institution is making a good faith effort to identify and obtain necessary state authorization before that date.

On July 12, 2011, however, the U.S. District Court for the District of Columbia vacated the portion of the Department of Education’s state authorization regulation that requires online education providers to obtain any required authorizations from all states in which their students reside, finding that the Department of Education had failed to provide sufficient notice and opportunity for comment on the requirement. On June 5, 2012, the U.S. Court of Appeals for the District of Columbia affirmed the district court's July 12, 2011 ruling. On July 27, 2012, the Department of Education issued a Dear Colleague Letter cautioning education institutions to remain in compliance with all applicable state laws and regulations related to distance education. The Department of Education has not announced its next steps, but it may engage in the future in a negotiated rulemaking to address distance education and state authorization. Should the federal distance education requirements published in October 2010 be enforced in the future, and if we fail to obtain required state authorization to provide postsecondary distance education in a specific state, we could lose our ability to award Title IV aid to students in that state.

Administrative Capability. Current Department of Education regulations specify extensive criteria by which an institution must establish that it has the requisite "administrative capability" to participate in Title IV programs. Failure to satisfy any of the standards may lead the Department of Education to find the institution ineligible to participate in Title IV programs or to place the institution on provisional certification as a condition of its participation. To meet the administrative capability standards, an institution must, among other things:

- comply with all applicable Title IV program regulations;
- have capable and sufficient personnel to administer Title IV programs;
- have acceptable methods of defining and measuring the satisfactory academic progress of its students;
- not have cohort default rates above specified levels;
- have various procedures in place for safeguarding federal funds;
- not be, and not have any principal or affiliate who is, debarred or suspended from federal contracting or engaging in activity that is cause for debarment or suspension;
- provide financial aid counseling to its students;
- refer to the Department of Education's Office of Inspector General any credible information indicating that any applicant, student, employee or agent of the institution has been engaged in any fraud or other illegal conduct involving Title IV programs;
- submit in a timely manner all reports and financial statements required by the regulations;
- report annually to the Secretary of Education on any reasonable reimbursements paid or provided by a private education lender or group of lenders to any employee who is employed in the institution's financial aid office or who otherwise has responsibilities with respect to education loans;
- develop and apply an adequate system to identify and resolve discrepant information with respect to a student's application for Title IV aid; and
- not otherwise appear to lack administrative capability.

The Department of Education's final regulations published on October 29, 2010 amend the Department's administrative capability standards in two respects. First, the final rules make a number of changes related to defining and measuring the satisfactory academic progress of students. Among other changes, the new rules require that an institution must evaluate satisfactory academic progress (1) at the end of each payment period if the length of the educational program is one academic year or less or (2) for all other educational programs, at the end of each payment period or at least annually to correspond to the end of a payment period. Second, the new regulations add an administrative capability standard related to the existing requirement that students must have a high school diploma or its recognized equivalent in order to be eligible for Title IV aid. Under the new administrative capability standard, institutions must develop and follow procedures for evaluating the validity of a student's high school diploma if the institution or the Secretary of Education has reason to believe that the student's diploma is not valid.

If an institution fails to satisfy any administrative capability criteria or any other Department of Education regulation, the Department of Education may:

- require the repayment of Title IV funds;
- transfer the institution from the “advance” system of payment of Title IV funds to cash monitoring status or to the “reimbursement” system of payment;
- place the institution on provisional certification status; or
- commence a proceeding to impose a fine or to limit, suspend, or terminate the participation of the institution in Title IV programs.

If we are found not to have satisfied the Department of Education’s “administrative capability” requirements, we could lose, or be limited in our access to, Title IV program funding.

Third-Party Servicers. Department of Education regulations permit an institution to enter into a written contract with a third-party servicer for the administration of any aspect of the institution’s participation in Title IV programs. The third-party servicer must, among other obligations, comply with Title IV requirements and be jointly and severally liable with the institution to the Secretary of Education for any violation by the servicer of any Title IV provision. An institution must report to the Department of Education new contracts with or any significant modifications to contracts with third-party servicers as well as other matters related to third-party servicers. If any third-party servicer that we engage does not comply with applicable statute and regulations including the Higher Education Act, we may be liable for its actions, and we could lose our eligibility to participate in Title IV programs. We recently determined to terminate our relationship with Global Financial Aid Services, Inc., which had assisted us with administration of our participation in Title IV programs since we began to participate in those programs in 2006, and to administer our participation in Title IV programs internally, using third party software.

Financial Responsibility. The Higher Education Act and Department of Education regulations establish extensive standards of financial responsibility that institutions such as us must satisfy in order to participate in Title IV programs. These standards generally require that an institution provide the resources necessary to comply with Title IV program requirements and meet all of its financial obligations, including required refunds and any repayments to the Department of Education for liabilities incurred in programs administered by the Department of Education.

The Department of Education evaluates institutions on an annual basis for compliance with specified financial responsibility standards. Generally, the standards require an institution to receive an unqualified opinion from its accountants on its audited financial statements, maintain sufficient cash reserves to satisfy refund requirements, meet all of its financial obligations, and remain current on its debt payments. The financial responsibility standards include a complex formula that uses line items from the institution's audited financial statements. The formula focuses on three financial ratios: (1) equity ratio (which measures the institution's capital resources, financial viability, and ability to borrow); (2) primary reserve ratio (which measures the institution's viability and liquidity); and (3) net income ratio (which measures the institution's profitability or ability to operate within its means). An institution's financial ratios must yield a composite score of at least 1.5 for the institution to be deemed financially responsible without the need for further federal oversight. The Department of Education may also apply such measures of financial responsibility to the operating company and ownership entities of an eligible institution. At the request of the Department of Education, we supply our consolidated financial statements to the Department of Education for purposes of calculating the composite score. We have applied the financial responsibility standards to our consolidated financial statements as of and for the year ended December 31, 2012, and calculated a composite score of 3.0 out of a maximum score of 3.0. We therefore believe that we meet the Department of Education's composite score standards. If the Department of Education were to determine that we did not meet the financial responsibility standards due to a failure to meet the composite score or other factors, we may be able to establish financial responsibility on an alternative basis by, among other things:

posting a letter of credit in an amount equal to at least 50% of the total Title IV program funds received by us during our most recently completed fiscal year;

posting a letter of credit in an amount equal to at least 10% of such prior year's Title IV program funds received by us, accepting provisional certification, complying with additional Department of Education monitoring requirements and agreeing to receive Title IV program funds under an arrangement other than the Department of Education's standard advance payment arrangement such as the "reimbursement" system of payment or cash monitoring; or

complying with additional Department of Education monitoring requirements and agreeing to receive Title IV program funds under an arrangement other than the Department of Education's standard advance payment arrangement such as the "reimbursement" system of payment or cash monitoring.

Failure to meet the Department of Education's "financial responsibility" requirements, because we do not meet the Department of Education's minimum composite score to establish financial responsibility or are unable to establish financial responsibility on an alternative basis or fail to meet other financial responsibility requirements, would cause us to lose access to Title IV program funding.

Title IV Return of Funds. Under the Department of Education's return of funds regulations, when a student withdraws, an institution must return unearned funds to the Department of Education in a timely manner. An institution must first determine the amount of Title IV program funds that a student "earned." If the student withdraws during the first 60% of any period of enrollment or payment period, the amount of Title IV program funds that the student earned is equal to a pro rata portion of the funds for which the student would otherwise be eligible. If the student withdraws after the 60% threshold, then the student has earned 100% of the Title IV program funds. The Department of Education's final regulations published on October 29, 2010 establish several new rules for determining when a student is considered withdrawn. Those rules went into effect July 1, 2011, and the Department of Education provided interpretive guidance in a July 20, 2011 “Dear Colleague Letter.” Under the final regulations, an institution generally must treat a student in a module (defined as a course or courses that do not span the entire length of the payment period or enrollment period) as withdrawn if the student does not complete all the instructional time that the student was scheduled to complete prior to withdrawing. We offer standard term-based modules and therefore must comply with the new rule. In addition, in certain circumstances, we use a student’s last day of attendance at an academically-related activity as the student’s withdrawal date for Title IV purposes. Under the final regulations, institutions that use the last day of attendance at an academically-related activity must determine the relevant date based on accurate institutional records (not a student’s certificate of attendance). For online classes, “academic attendance” means engaging in an academically-related activity, such as participating in class through an online discussion or initiating contact with a faculty member to ask a question; simply logging into an online class does not constitute “academic attendance” for purposes of the return of funds requirements.

The institution must return to the appropriate Title IV programs, in a specified order, the lesser of (i) the unearned Title IV program funds or (ii) the institutional charges incurred by the student for the period multiplied by the percentage of unearned Title IV program funds. An institution must return the funds no later than 45 days after the date of the institution's determination that a student withdrew. If such payments are not timely made, an institution may be subject to adverse action, including being required to submit a letter of credit equal to 25% of the refunds the institution should have made in its most recently completed fiscal year. Under Department of Education regulations, late returns of Title IV program funds for 5% or more of students sampled in the institution's annual compliance audit constitutes material noncompliance.

The "90/10 Rule."   A requirement of the Higher Education Act, commonly referred to as the "90/10 Rule," applies only to "proprietary institutions of higher education," which includes us. As discussed above, under the Higher Education Act, a proprietary institution is prohibited from deriving from Title IV funds, on a cash accounting basis (except for certain institutional loans) for any fiscal year, more than 90% of its revenues (as computed for 90/10 Rule purposes). Prior to the adoption of HEOA, an institution that violated the rule became ineligible to participate in Title IV programs as of the first day of the fiscal year following the fiscal year in which its Title IV revenue exceeded 90% of its revenues, and it was unable to apply to regain its eligibility until the next fiscal year.

HEOA changed the 90/10 Rule from an eligibility requirement to a compliance obligation that is part of an institution's program participation agreement with the Department of Education. Accordingly, HEOA generally lessens the severity of noncompliance with the 90/10 Rule, although repeated noncompliance will result in loss of eligibility to participate in Title IV programs. Under the terms of HEOA, a proprietary institution of higher education that violates the 90/10 Rule for any fiscal year will be placed on provisional status for two fiscal years. Proprietary institutions of higher education that violate the 90/10 Rule for two consecutive fiscal years will become ineligible to participate in Title IV programs for at least two fiscal years and will be required to demonstrate compliance with Title IV eligibility and certification requirements for at least two fiscal years prior to resuming Title IV program participation. HEOA requires the Secretary of Education to disclose on its website any proprietary institution of higher education that fails to meet the 90/10 requirement and to report annually to Congress the relevant ratios for each proprietary institution of higher education. HEOA generally codifies the formula for 90/10 Rule calculations as set forth in preceding Department of Education regulations, but also expands on the Department of Education's formula in certain respects, including by broadening the categories of funds that may be counted as non-Title IV revenue for 90/10 Rule purposes. HEOA's changes to the 90/10 Rule took effect upon enactment, which occurred on August 14, 2008.

The Department of Education issued final regulations implementing the 90/10 Rule and certain other HEOA provisions on October 29, 2009. The final regulations were effective July 1, 2010. The regulations generally track the HEOA provisions, but clarify the treatment of certain types of revenue. The regulations require institutions to report in their annual financial statement audits not only the percentage of revenues derived from Title IV funds during the fiscal year, but also the dollar amount of the numerator and denominator of the 90/10 calculation and specified categories of revenue. The regulations shorten from 90 to 45 days the time period within which institutions must notify the Secretary of Education after the end of a fiscal year in which the institution failed to meet the 90/10 requirement.

Using the formula in effect prior to enactment of HEOA, we derived approximately 19% of our cash-basis revenues from eligible programs in 2008 compared to 14% in 2007 and 1% in 2006. Using the HEOA formula, we derived approximately 19%, 26% and 42% of our cash-basis revenues from Title IV program funds in 2009, 2010and 2011, respectively. Our percentage of cash-based revenues from Title IV program funds has increased as our population of students using Title IV program funds has increased. The population of our students using these funds is growing at a faster rate than students who use other sources of revenues, and we will continue to monitor compliance with the 90/10 Rule.

In addition, certain members of Congress have stated that Congress should revise the 90/10 Rule to count DoD tuition assistance and veterans education benefits toward the 90% limit. For example, members of Congress raised this idea both in the September 2010 hearing before the House Armed Services Committee's Subcommittee on Oversight and Investigations reviewing DoD's oversight of distance education and for-profit institutions and in a December 2010 HELP Committee report examining the growing share of DoD tuition assistance and Post-9/11 GI Bill benefits flowing to for-profit institutions. Because we receive a substantial portion of our revenues from DoD tuition assistance and veterans educational benefits, such a change would significantly increase our risk of violating the 90/10 Rule. In January 2012, Senators Harkin and Durbin introduced a bill to modify the 90/10 Rule by reducing the threshold to 85% and counting the Title IV programs, the DoD tuition assistance program, and veterans education benefits programs as sources from which an institution may derive no more than 85% of its revenue. In February 2012, companion bills were introduced in the U.S. Senate and U.S. House of Representatives that would modify the 90/10 Rule to count DoD tuition assistance and veterans education benefits toward the 90% limit, along with Title IV programs. On May 29, 2012, attorneys general for 21 states called on Congress to enact this type of legislation. We cannot predict the likelihood that Congress will amend the 90/10 Rule to count DoD tuition assistance and veterans education benefits toward the 90% limit or to lower the ratio to 85/15. If the calculation for purposes of the 90/10 Rule is changed so that DoD tuition assistance and/or veterans education benefits are counted toward a 90% or 85% limit, our percentage of revenues that would count toward such limit would be significantly higher than our current 90/10 calculation. We are not required to include all federal funding in our 90/10 calculation and do not track sources of funds for this purpose. Accordingly, we cannot estimate with precision what our percentage would be if any of these proposed amendments to the 90/10 Rule are made by Congress.. However, based on our assessment of net course registrations, we currently estimate that approximately 87% of our funding is derived from federal sources.

Student Loan Defaults. Under the Higher Education Act, an educational institution may lose its eligibility to participate in some or all of the Title IV programs if defaults on the repayment of FFEL program or Direct Loan Program loans by its students exceed certain levels. For each federal fiscal year, a rate of student defaults (known as a "cohort default rate") is calculated for each institution with 30 or more borrowers entering repayment in a given federal fiscal year by determining the rate at which borrowers who become subject to their repayment obligation in that federal fiscal year default by the end of the next federal fiscal year. For such institutions, the Department of Education calculates a single cohort default rate for each federal fiscal year that includes in the cohort all current or former student borrowers at the institution who entered repayment on any FFEL program or Direct Loan Program loan during that year. Such rate is referred to as the "two-year cohort default rate."

If the Department of Education notifies an institution that its two-year cohort default rates for each of the three most recent federal fiscal years are 25% or greater, the institution's participation in the FFEL program, Direct Loan Program, and Pell program ends 30 days after the notification, unless the institution timely appeals that determination on specified grounds and according to specified procedures. In addition, an institution's participation in the FFEL program and Direct Loan Program ends 30 days after notification that its most recent two-year cohort default rate is greater than 40%, unless the institution timely appeals that determination on specified grounds and according to specified procedures. An institution whose participation ends under these provisions may not participate in the relevant programs for the remainder of the fiscal year in which the institution receives the notification, as well as for the next two fiscal years.

If an institution's two-year cohort default rate equals or exceeds 25% in any single year, the institution may be placed on provisional certification status. Provisional certification does not limit an institution's access to Title IV program funds; however, an institution with provisional status is subject to closer review by the Department of Education and may be subject to summary adverse action if it violates Title IV program requirements.

The three most recent federal fiscal years for which FFEL/Direct Loan cohort defaults rates have been officially calculated are federal fiscal years 2008, 2009, and 2010. Because we began only recently to enroll students who are participating in the federal student loan programs, we have no historical cohort default rate for federal fiscal year 2007. Our cohort default rate for federal fiscal years 2008, 2009 and 2010, respectively, is 5.2%, 4.0% and 6.0%. Relatively few students are expected to enter the repayment repayment phase in the near term, which could result in defaults by a few students having a relatively large impact on our cohort default rate.

HEOA extends by one year the period for measuring the cohort default rate for FFEL program and Direct Loan program loans. Beginning with cohort default rate calculations for federal fiscal year 2009, the cohort default rate will be calculated by determining the rate at which borrowers who become subject to their repayment obligation in the relevant federal fiscal year default by the end of the second following federal fiscal year. Such rate is referred to as the "three-year cohort default rate." The current method of calculating rates will remain in effect and will be used to determine any sanctions on institutions because of their cohort default rates, namely the two-year cohort default rate, until three consecutive years of official cohort default rates calculated under the new formula are available – i.e., in 2014.

The HEOA also increases the cohort default rate ceiling from 25% to 30%. The HEOA provides for the following sanctions based on cohort default rates calculated under the new HEOA methodology:

> An institution whose three-year cohort default rate is equal to or greater than 30% for each of the three most recent federal fiscal years for which data are available will be ineligible to participate in the FFEL Program, Direct Loan Program, and Federal Pell Grant Program.

If an institution's three-year cohort default rate is 30% or more in a given fiscal year, the institution will be required to assemble a "default prevention task force" and submit to the Department of Education a default improvement plan.

An institution whose three-year cohort default rate exceeds 30% for two consecutive years will be required to review, revise, and resubmit its default improvement plan, and the Department of Education may direct that such plan be amended to include actions, with measurable objectives, that it determines will promote loan repayment.

The Department of Education may subject an institution to provisional certification if the institution's three-year cohort default rate is 30% or more for any two consecutive federal fiscal years. An institution whose three-year cohort default rate is 30% or more for any two consecutive federal fiscal years may file an appeal on specified grounds and according to specified procedures, and if the Secretary of Education determines that the institution has demonstrated grounds for relief, the Secretary may not subject the institution to provisional certification based solely on the institution's cohort default rate.

HEOA does not change the current provision that an institution generally loses eligibility to participate in the FFEL Program and the Direct Loan Program if its most recent cohort default rate is greater than 40%.

In October 2009, the Department of Education issued final regulations to implement the HEOA provisions on cohort default rates and other student loan matters. Those regulations became effective July 1, 2010. The final regulations provide that the Department of Education will issue two cohort default rates -- a rate calculated in accordance with pre-HEOA methodology (two-year rate) and a rate calculated in accordance with HEOA methodology (three-year rate) -- for fiscal years 2009 through 2011. The final regulations also indicate that the Department of Education will rely on the two-year rate and related thresholds to determine institutional eligibility until 2014, when the Department of Education issues official three-year rates for the federal fiscal year 2011 cohort.

In December 2009, the Department of Education sent to institutions unofficial, “trial” cohort default rates showing institutions’ cohort default rates for federal fiscal years 2005, 2006, and 2007 as they would be calculated under the HEOA methodology. Three-year cohort default rates were generally expected to be higher than two-year cohort default rates, because of both the longer repayment history and current economic conditions. Our “trial” three-year cohort default rates are 0.0%, 0.0%, and 3.3% for federal fiscal years 2005, 2006, and 2007, respectively. In February 2011, the Department of Education published “trial” three-year cohort default rates for fiscal year 2008. Our “trial” cohort default rate for federal fiscal year 2008 was 11.4%. In April 2011, the Department of Education issued corrected “trial” cohort default rates for 2008. Our corrected rate was 11.0%. Our official three-year cohort default rate for 2009 is 7.2%.

Incentive Payment Rules. As part of an institution’s program participation agreement with the Department of Education and in accordance with the Higher Education Act, an institution may not provide any commission, bonus or other incentive payment to any person or entity engaged in any student recruitment, admissions, or financial aid awarding activity based directly or indirectly on success in securing enrollments or financial aid. Failure to comply with the incentive payment rule could result in termination of participation in Title IV programs, limitation on participation in Title IV programs, or financial penalties.

In 2002, the Department of Education promulgated 12 “safe harbors” setting forth certain permissible activities and arrangements under the incentive payment regulation. The final regulations published on October 29, 2010 abolished the 12 safe harbors and modified the regulation to codify a stricter reading of the incentive payment provision. The final rule became effective July 1, 2011. In March 2011, the Department of Education issued guidance on the revised incentive payment regulation. Certain ambiguities in the final rule and the Department of Education’s accompanying statements and March 2011 guidance create uncertainty as to how the revised rule will be interpreted and enforced by the Department of Education.

On June 5, 2012, the U.S. Court of Appeals for the District of Columbia Circuit held that the elimination of the safe harbor for compensation “based upon students successfully completing their educational programs, or one academic year of their educational programs” was arbitrary and capricious. The court remanded for the Department of Education to provide further explanation for the elimination. In addition, the court required the Department of Education to address comments on the regulations, raised during the comment period, that the compensation regulations may have an adverse effect on minority enrollment.

We believe that our current employee compensation and third-party contractual arrangements comply with the incentive payment provisions of the Higher Education Act and Department of Education regulations currently in effect However, in light of the uncertainties surrounding the revised rule and ambiguities in the Department of Education’s related guidance, or otherwise, we can make no assurances that the Department would not find deficiencies in our current or future employee compensation plans contractual arrangements. Similarly, there can be no assurance that the Department of Education would not find deficiencies in our former and contractual arrangements. In addition, in recent years, other postsecondary educational institutions have been named as defendants to whistleblower lawsuits, known as "qui tam" cases, brought by current or former employees pursuant to the Federal False Claims Act, alleging that their institution's compensation practices did not comply with the incentive compensation rule. A qui tam case is a civil lawsuit brought by one or more individuals, referred to as a relator, on behalf of the federal government for an alleged submission to the government of a false claim for payment. The relator, often a current or former employee, is entitled to a share of the government's recovery in the case, including the possibility of treble damages. A qui tam action is always filed under seal and remains under seal until the government decides whether to intervene in the case. If the government intervenes, it takes over primary control of the litigation. If the government declines to intervene in the case, the relator may nonetheless elect to continue to pursue the litigation at his or her own expense on behalf of the government. Any such litigation could be costly and could divert management's time and attention away from the business, regardless of whether a claim has merit.

In October 2010, the GAO released a report entitled “Higher Education: Stronger Federal Oversight Needed to Enforce Ban on Incentive Payments to School Recruiters” finding that the Department of Education has inadequately enforced the current ban on incentive payments. In response, the Department has undertaken to increase its enforcement efforts by, among other approaches, strengthening procedures provided to auditors reviewing institutions for compliance with the incentive payments ban and updating its internal compliance guidance in light of the GAO findings and the revised incentive payment rule that took effect July 1, 2011.

Code of Conduct Related to Student Loans. As part of an institution’s program participation agreement with the Department of Education, HEOA requires that institutions that participate in Title IV programs adopt a code of conduct pertinent to student loans. For financial aid office or other employees who have responsibility related to education loans, the code must forbid, with limited exceptions, gifts, consulting arrangements with lenders, and advisory board compensation other than reasonable expense reimbursement. The code also must ban revenue-sharing arrangements, “opportunity pools” that lenders offer in exchange for certain promises, and staffing assistance from lenders. The institution must post the code prominently on its website and ensure that its officers, employees, and agents who have financial aid responsibilities are informed annually of the code’s provisions. In addition to the code of conduct requirements that apply to institutions, HEOA contains provisions that apply to private lenders, prohibiting such lenders from engaging in certain activities as they interact with institutions. Failure to comply with the code of conduct provision could result in termination of our participation in Title IV programs, limitations on participation in Title IV programs, or financial penalties.

Misrepresentation. The Higher Education Act and current regulations authorize the Department of Education to take action against an institution that participates in Title IV programs for any “substantial misrepresentation” made by that institution regarding the nature of its educational program, its financial charges, or the employability of its graduates. Effective July 1, 2011, the final regulations published on October 29, 2010 expand the definition of “substantial misrepresentation” to cover additional representatives of the institution and additional substantive areas and expands the parties to whom a substantial misrepresentation cannot be made. The regulations also augment the actions the Department of Education may take if it determines that an institution has engaged in substantial misrepresentation. Under the final regulations, the Department of Education may revoke an institution’s program participation agreement, impose limitations on an institution’s participation in Title IV programs, or initiate proceedings to impose a fine or to limit, suspend, or terminate the institution’s participation in Title IV programs. On June 5, 2012, the U.S. Court of Appeals for the District of Columbia vacated portions of the substantial misrepresentation regulation that permitted the U.S. Department of Education to: (i) revoke an institution's program participation agreement or impose limitations on an institution's participation without affording procedural protections; (ii) proscribe misrepresentations with respect to subjects not covered by the Higher Education Act; and (iii) proscribe statements that are merely confusing. The court remanded the matters so that the Department of Education can revise the regulations. The Department of Education could promulgate regulations that expand its role in monitoring and enforcing prohibitions on misrepresentation.

Credit Hours. The Higher Education Act and current regulations use the term “credit hour” to define an eligible program and an academic year and to determine enrollment status and the amount of Title IV aid an institution may disburse during a payment period. Recently, both Congress and the Department of Education have increased their focus on institutions’ policies for awarding credit hours. As discussed above, in June 2010, a House Education and Labor Committee hearing examined accrediting agencies’ standards for assessing institutions’ credit hour policies. The final regulations published on October 29, 2010 define the previously undefined term “credit hour” in terms of a certain amount of time in class and outside class, or an equivalent amount of work. The regulations also require accrediting agencies to review the reliability and accuracy of an institution’s credit hour assignments. If an accreditor identifies systematic or significant noncompliance in one or more of an institution’s programs, the accreditor must notify the Secretary of Education.

As of July 1, 2011, if the Department of Education determines that an institution is out of compliance with the credit hour definition, the Department could require the institution to repay the incorrectly awarded amounts of Title IV aid. In addition, if the Department determines that an institution has significantly overstated the amount of credit hours assigned to a program, the Department may fine the institution, or limit, suspend, or terminate its participation in the Title IV programs.

College Affordability and Transparency Lists.   Under HEOA, the Department of Education has published on its website lists of the top 5% of institutions, in each of nine categories, with (1) the highest tuition and fees for the most recent academic year, (2) the highest "net price" for the most recent academic year, (3) the largest percentage increase in tuition and fees for the most recent three academic years, and (4) the largest percentage increase in net price for the most recent three academic years. An institution that is placed on a list for high percentage increases in either tuition and fees or in net price must submit a report to the Department of Education explaining the increases and the steps that it intends to take to reduce costs. The Department of Education will report annually to Congress on these institutions and will publish their reports on its web site. The Department of Education also posts lists of the top 10% of institutions in each of the nine categories with lowest tuition and fees or the lowest net price for the most recent academic year. Under HEOA, net price means average yearly price actually charged to first-time, full-time undergraduate students who receive student aid at a higher education institution after such aid is deducted. Currently, we are listed as the institution with the lowest tuition among private for-profit, four-year or above institutions. We are also listed as the institution with the eighth lowest net price among private for-profit, four-year or above institutions. We cannot predict with certainty the effect such lists will have on our operations.

Compliance Reviews. We are subject to announced and unannounced compliance reviews and audits by various external agencies, including the Department of Education, OIG, state licensing agencies, agencies that guarantee FFEL program loans, the Department of Veterans Affairs, and accrediting agencies. As part of the Department of Education's ongoing monitoring of institutions' administration of Title IV programs, the Higher Education Act and Department of Education regulations also require institutions to submit annually a compliance audit conducted by an independent certified public accountant in accordance with Government Auditing Standards and applicable audit standards of the Department of Education. In addition, to enable the Secretary of Education to make a determination of financial responsibility, institutions must annually submit audited financial statements prepared in accordance with Department of Education regulations. In August 2010, the Secretary of Education sent a letter to several members of the Senate HELP Committee responding to the findings of the GAO's undercover investigation. The Secretary explained that the Department of Education plans to strengthen its oversight of Title IV programs through, among other approaches, increasing the number of program reviews by 50%, from 200 conducted in 2010 up to 300 reviews in 2011.

On February 28, 2011 the U.S. Department of Education began an on-site program review of APUS' administration of the Title IV programs. In general, after the Department of Education conducts its site visit and reviews data supplied by the institution, the Department of Education sends the institution a program review report. The institution has the opportunity to respond to the findings in the program review report. The Department of Education then issues a final program review determination letter, which identifies any liabilities. The institution may appeal any monetary liabilities specified in the final program review determination letter. The site visit for our program review, which covered the 2009-2010 and 2010-2011 award years, took place from February 28, 2011 through March 4, 2011.

APUS received the program review report in April 2011. The report included three findings, two of which involve individual student specific errors. The third finding was that APUS' policies failed to treat certain students as having unofficially withdrawn from the institution and that the University consequently failed to calculate and return federal student financial aid that APUS was required to return to the Department of Education as the result of these unofficial withdrawals. The Department's position is that students who did not "earn an F grade" in a payment period should be treated as having unofficially withdrawn from the school, even if they had future course registrations in the next payment period. We disagree with this interpretation of Department of Education regulations, and APUS filed a response to the Department of Education in June 2011 and responded to follow-up requests from the Department of Education.

On May 14, 2012 the Department of Education issued a Final Program Review Determination, or FPRD. The FPRD (1) identified liabilities resulting from the program review report findings, (2) provided instructions for payment of the liabilities to the Department of Education, (3) notified APUS of its right to appeal, and (4) notified APUS that under Department of Education regulations, APUS was required to post an irrevocable letter of credit payable to the U.S. Secretary of Education due to the number of unpaid and late refunds identified as part of the program review. The liabilities and letter of credit requirements are based on the program review report's finding that APUS' policies improperly failed to treat certain students as having unofficially withdrawn from the institution and that APUS consequently failed to calculate and return federal student financial aid to the Department of Education as a result of these unofficial withdrawals. The FPRD stated that APUS' total monetary liability, including interest, was $1,040,851. Notwithstanding that the Company disagreed with the Department's position, after considering the time, effort, expense and other factors involved in a full appeal, the Company determined to pay the liability. After paying a portion of the liability, APUS timely appealed the remaining amount because it discovered discrepancies in the Department of Education's records as compared to its records for certain students at issue in the FPRD. By letter dated July 24, 2012, the Department of Education withdrew the FPRD without prejudice and indicated its intent to reissue a revised FPRD at a later date. APUS subsequently received a revised FPRD Letter dated August 8, 2012. The August 8 FPRD Letter was substantially similar to the May 14 FPRD Letter but it provided for a reduced liability amount. The total liability amount in the May 14 FPRD Letter was $1,040,851; the total liability amount in the

August 8 FPRD Letter was $1,033,403. By the time of the August 8 FPRD Letter, APUS had already paid $909,095 based on the May 14 FPRD. In addition, the Company accrued $56,000 at June 30, 2012 for interest expense related to the FPRD. APUS determined that it would not appeal the August 8 FPRD Letter, and in a courtesy letter to Department of Education it undertook to pay the remaining amount due as specified in the FPRD. Because we cannot be assured that we will be able to collect the full amounts from the relevant former students, we have established a reserve against these receivables. We will continue to monitor the collection history and the reserve established. In response to the FPRD, we have also posted an irrevocable letter of credit in favor of the Department of Education in the amount of $163,284.

Privacy. The Family Educational Rights and Privacy Act of 1974, or FERPA, and the Department of Education's FERPA regulations require institutions to allow students to review and request changes to such student's education records maintained by the institution, notify students at least annually of this inspection right, and maintain records in each student's file listing requests for access to and disclosures of personally identifiable information and the interest of such party in the student's personally identifiable information. FERPA also limits the disclosure of a student's personally identifiable information by an institution without such student's prior written consent. If an institution fails to comply with FERPA or the Department of Education's FERPA regulations, the Department of Education may require corrective actions by the institution, withhold further payments under any applicable Title IV program or terminate an institution's eligibility to participate in Title IV programs. In addition, an institution participating in any Title IV program is obligated to safeguard customer information pursuant to applicable provisions of the Gramm-Leach-Bliley Act, or GLBA, and Federal Trade Commission, or FTC, regulations. GLBA and FTC regulations require an institution to develop and maintain a comprehensive information security program to protect personally identifiable financial information of students, parents or other individuals with whom an institution has a customer relationship. If an institution fails to comply with GLBA or FTC regulations, it may be required to take corrective actions, be subject to FTC monitoring and oversight, and be subject to fines or penalties imposed by the FTC.

Potential Effect of Regulatory Violations. If we fail to comply with the regulatory standards governing Title IV programs, the Department of Education could impose one or more sanctions, including transferring us to the reimbursement or cash monitoring system of payment, seeking to require repayment of certain Title IV program funds, requiring us to post a letter of credit in favor of the Department of Education as a condition for continued Title IV certification, taking emergency action against us, referring the matter for criminal prosecution or initiating proceedings to impose a fine or to limit, condition, suspend, or terminate our participation in Title IV programs. If such sanctions or proceedings were imposed against us and resulted in a substantial curtailment, or termination, of our participation in Title IV programs, our enrollments, revenues, and results of operations would be materially and adversely affected.

If we lost our eligibility to participate in Title IV programs, or if Congress reduced the amount of available federal student financial aid, we would seek to arrange or provide alternative sources of revenue or financial aid for students. Although we believe that one or more private organizations would be willing to provide financial assistance to students attending our universities, there is no assurance that this would be the case, and the interest rate and other terms of such financial aid might not be as favorable as those for Title IV program funds. We may be required to guarantee all or part of such alternative assistance or might incur other additional costs in connection with securing alternative sources of financial aid. Accordingly, the loss of our eligibility to participate in Title IV programs, or a reduction in the amount of available federal student financial aid, would be expected to have a material adverse effect on our growth plans and results of operations even if we could arrange or provide alternative sources of revenue or student financial aid.

In addition to the actions that may be brought against us as a result of our participation in Title IV, we also may be subject, from time to time, to complaints and lawsuits relating to regulatory compliance brought not only by our regulatory agencies, but also by other government agencies and third parties, such as present or former students or employees and other members of the public.

Regulatory Actions and Restrictions on Operations

Many actions that we may wish to take in connection with our operations are also subject to regulation from a variety of agencies.

Restrictions on Adding Educational Programs. State requirements and accrediting agency standards may, in certain instances, limit our ability to establish additional programs. Many states require approval before institutions can add new programs under specified conditions. The Higher Learning Commission and the West Virginia Higher Education Policy Commission generally require institutions to notify them in advance of implementing new programs, and upon notification, may undertake a review of the institution’s licensure, authorization, or accreditation.

The Higher Education Act and Department of Education regulations require a proprietary institution of higher education to have been in existence for at least two years in order to be eligible to participate in Title IV programs. An institution subject to the two-year rule may not award Title IV funds to a student in a program that is not included in the institution’s approval documents. During the institution’s initial period of participation in Title IV programs, the Department of Education will not approve additional programs that would expand the scope of the institution’s eligibility.

In addition, when an institution is certified for the first time, its certification is provisional until the Department of Education has reviewed a compliance audit that covers a complete fiscal year of Title IV program participation and has decided to certify fully the institution. In the first quarter of 2008, we timely filed a recertification application because our initial period of certification was scheduled to end on June 30, 2008. As part of that recertification process, the Department of Education fully certified us, and it no longer considers us to be in our initial period of certification. However, in August 2008, we were deemed to have undergone a change in ownership and control requiring review by the Department of Education in order to reestablish our eligibility and continue participation in Title IV programs. On October 2, 2008, the Department of Education approved our change in ownership application and granted us provisional certification for a two-year period ending September 30, 2010. During that period, our program participation agreement provided that, as a provisionally certified institution, we had to apply for and receive approval by the Secretary of Education for any substantial change. Under our program participation agreement, substantial changes included but were not limited to establishment of additional locations, an increase in the level of academic offering, and addition of any non-degree or short-term training program. The Department of Education advised us that an institution that is provisionally certified based on a change in ownership and control that resulted from a reduction of ownership interest is able to add new degree programs under the same conditions that apply to a fully certified institution. On July 2, 2010, we received a letter from the Department of Education notifying us that we are fully recertified to participate in Title IV programs through December 31, 2014, and that we are no longer provisionally certified.

Generally, under regulations in effect prior to July 1, 2011, if an institution that was not subject to the two-year rule or was not in its initial period of certification added an educational program after it had been designated as an eligible institution, the institution was required to apply to the Department of Education to have the additional program designated as eligible. However, a fully certified degree-granting institution was not obligated to obtain the Department of Education's approval of additional programs that led to an associate, bachelor's, professional, or graduate degree at the same degree level(s) previously approved by the Department of Education. Similarly, a fully certified institution was not required to obtain advance approval for new programs that both prepared students for gainful employment in the same or related recognized occupation as an educational program that had previously been designated as an eligible program at that institution and met certain minimum-length requirements. However, the Department of Education, as a condition of certification to participate in Title IV programs, could require prior approval of such programs or otherwise restrict the number of programs an institution may add. In the event that an institution that was required to obtain the Department of Education's express approval for the addition of a new program failed to do so, and erroneously determined that the new educational program was eligible for Title IV program funds, the institution could be liable for repayment of Title IV program funds received by the institution or students in connection with that program.

The final regulations published on October 29, 2010 establish a new process under which an institution must apply for approval to offer a program that, under the Higher Education Act, prepares students for "gainful employment in a recognized occupation" in order to be eligible for Title IV funds. Effective July 1, 2011, an institution must notify the Department of Education at least 90 days before the first day of classes when it intends to add a program that prepares students for gainful employment. On September 27, 2011, the Department of Education issued an NPRM proposing a streamlined approval process that targets only the worst-performing programs, specifically programs that are the same or substantially similar to previous programs that failed gainful employment metric(s). On June 30, 2012, the U.S. District Court for the District of Columbia struck down the gainful employment metrics and regulations related to notifying (and potentially obtaining approval from) ED for new programs. Pending a final ruling in this case, the Department of Education has advised schools to follow the rules on additional programs that immediately preceded the gainful employment rules. For more information about the gainful employment regulations, see above "Regulation of Title IV Financial Aid Programs – Gainful Employment." The Department of Education may still, as a condition of certification to participate in Title IV programs, require prior approval of programs or otherwise restrict the number of programs an institution may add.

Change in Ownership Resulting in a Change of Control. Many states and accrediting agencies require institutions of higher education to report or obtain approval of certain changes in ownership or other aspects of institutional status, but the types of and triggers for such reporting or approval vary among states and accrediting agencies. In addition, our accrediting agencies, The Higher Learning Commission, requires institutions that it accredits to inform it in advance of any substantive change, including a change that significantly alters the ownership or control of the institution. Examples of substantive changes requiring advance notice to The Higher Learning Commission include changes in the legal status, ownership, or form of control of the institution, such as the sale of a proprietary institution. Also, The Higher Learning Commission must approve a substantive change in advance in order to include the change in the institution's accreditation status. In addition, The Higher Learning Commission also requires an on-site evaluation within six months to confirm the appropriateness of the approval.

In June 2009 and February 2010, The Higher Learning Commission adopted and revised, respectively, new policies related to institutional control, structure, and organization. Part of The Higher Learning Commission's stated rationale for these changes was to better define the range of its oversight of transactions related to change of ownership at institutions. The new policies extend The Higher Learning Commission's oversight to transactions that change, or have the potential to change, the control of an institution or its fundamental structure and organization. Under the new policies, The Higher Learning Commission also now extends its oversight to defined changes that occur in a parent or controlling entity, and not necessarily in the institution itself. Actions by, or relating to, an accredited institution, including a significant acquisition of another institution, significant changes in board composition or organizational documents, and accumulations by one stockholder of greater than 25% of the capital stock, could open up an accredited institution to additional reviews by The Higher Learning Commission and possible change from an accredited status to candidate status, which enhances the risks associated with these types of actions. In particular, the change from accredited status to candidate status could adversely impact an institution’s ability to participate in Title IV programs. For-profit institutions may also be less attractive acquisition candidates because of the enhanced scrutiny of change in control transactions, the explicit ability to move an institution from accredited status to candidate status, and because The Higher Learning Commission will now also be looking more closely at entities that own accredited institutions.

The Higher Education Act provides that an institution that undergoes a change in ownership resulting in a change in control loses its eligibility to participate in Title IV programs and must apply to the Department of Education in order to reestablish such eligibility. An institution is ineligible to receive Title IV program funds during the period prior to recertification. The Higher Education Act provides that the Department of Education may temporarily provisionally certify an institution seeking approval of a change in ownership and control based on preliminary review by the Department of Education of a materially complete application received by the Department of Education within 10 business days after the transaction. The Department of Education may continue such temporary, provisional certification on a month-to-month basis until it has rendered a final decision on the institution's application. If the Department of Education determines to approve the application after a change in ownership and control, it issues a provisional certification, which extends for a period expiring not later than the end of the third complete award year following the date of provisional certification. Department of Education regulations describe some transactions that constitute a change of control, including the transfer of a controlling interest in the voting stock of an institution or the institution's parent corporation. Department of Education regulations provide that a change of control of a publicly traded corporation occurs in one of two ways: (i) if there is an event that would obligate the corporation to file a Current Report on Form 8-K with the SEC disclosing a change of control or (ii) if the corporation has a stockholder that owns at least 25% of the total outstanding voting stock of the corporation and is the largest stockholder of the corporation, and that stockholder ceases to own at least 25% of such stock or ceases to be the largest stockholder. A significant purchase or disposition of our voting stock could be determined by the Department of Education to be a change in ownership and control under this standard.

When a change of ownership resulting in a change of control occurs, the Department of Education applies a different set of financial tests to determine the financial responsibility of the institution in conjunction with its review and approval of the change of ownership. The institution generally is required to submit a same-day audited balance sheet reflecting the financial condition of the institution immediately following the change in ownership. The institution's same-day balance sheet must demonstrate an acid test ratio of at least 1:1, which is calculated by adding cash and cash equivalents to current accounts receivable and dividing the sum by total current liabilities (and excluding all unsecured or uncollateralized related party receivables). The same-day balance sheet must demonstrate positive tangible net worth. When a publicly traded company undergoes a change in ownership and control due to a reduction in ownership interest, as occurred when in August 2008 funds affiliated with ABS Capital Partners distributed shares of our stock to its general and limited partners, the institution may submit its most recent quarterly financial statement as filed with the SEC, along with copies of all other SEC filings made after the close of the fiscal year for which a compliance audit has been submitted to the Department of Education, instead of the "same day" balance sheet. In addition, when a change in ownership and control occurs and there is a new owner, the institution must submit to the Department of Education audited financial statements of the institution's new owner's two most recently completed fiscal years that are prepared and audited in accordance with Department of Education requirements. The Department may determine whether the financial statements meet financial responsibility standards with respect to the composite score formula. If the institution does not satisfy these requirements, the Department of Education may condition its approval of the change of ownership on the institution's agreeing to letters of credit, provisional certification, and/or additional monitoring requirements, as described in the above section on Financial Responsibility. If the new owner does not have the required audited financial statements, the Department of Education may impose certain restrictions on the institution, including with respect to adding locations and programs.

In August 2008, funds affiliated with ABS Capital Partners reduced their beneficial ownership interest from approximately 26% to approximately 24% of our outstanding common stock, and we were deemed to have undergone a change in ownership and control requiring review by the Department of Education in order to reestablish our eligibility and continue participation in Title IV programs. As required under Department of Education regulations, we timely notified the Department of Education of our change in ownership and control. In connection with the Department of Education's review of the change, we submitted to the Department of Education a change in ownership application that included the submission of required documentation, including a letter from The Higher Learning

Commission indicating that it had approved the change. On October 2, 2008, we received a letter from the Department of Education approving the change in ownership and control and granting us provisional certification until September 30, 2010. On July 2, 2010, we received a letter from the Department of Education notifying us that we are fully recertified to participate in Title IV programs through December 31, 2014.

Many states include the sale of a controlling interest of common stock in the definition of a change of control requiring approval. A change of control under the definitions of an agency that regulates us might require us to obtain approval of the change in ownership and control in order to maintain our regulatory approval. Under certain circumstances, the West Virginia Higher Education Policy Commission and the State Council of Higher Education for Virginia might require us to seek approval of changes in ownership and control in order to maintain our state authorization or licensure. With respect to the distribution by the funds affiliated with ABS Capital Partners, the State Council of Higher Education for Virginia did not consider the distribution to be a change in ownership under its regulations, and the West Virginia Higher Education Policy Commission approved the change.

Pursuant to federal law providing benefits for veterans and reservists, we are approved for education of veterans and members of the selective reserve and their dependents by the state approving agencies in West Virginia and Virginia. In certain circumstances, state approving agencies may require an institution to obtain approval for a change in ownership and control.

A change of control could occur as a result of future transactions in which we are involved. Some corporate reorganizations and some changes in the board of directors are examples of such transactions. Moreover, as a publicly traded company, the potential adverse effects of a change of control could influence future decisions by us and our stockholders regarding the sale, purchase, transfer, issuance, or redemption of our stock. In addition, the regulatory burdens and risks associated with a change of control also could discourage bids for your shares of common stock and could have an adverse effect on the market price of your shares.

Pending Regulatory Changes

Negotiated Rulemaking. On May 5, 2011, the Department of Education announced its intention to establish additional negotiated rulemaking committees to prepare proposed regulations under the Higher Education Act. Three public hearings were conducted in May 2011 at which interested parties suggested issues that should be considered for action by the negotiating committees. The Department of Education also conducted roundtable discussions to inform policy in the areas of teacher preparation, college completion, and the proposed “First in the World” competition. In spring 2012, the Department of Education convened two negotiated rulemaking committees -- one on teacher preparation and one on student loans – that each held a series of meetings to discuss proposed changes to applicable regulations. Negotiators reached consensus on proposed regulatory language on 25 student loan issues, which will result in two packages of proposed rules to be published for public comment before final promulgation. Proposed rules relating to various loan repayment issues, including a new income-based repayment plan for the Direct Loan program, were issued November 1, 2012. Although the rule was originally scheduled to become effective on July 1, 2013, the Department of Education announced the rule would go into effect on December 21, 2012. Also, the Department of Education issued a NPRM on July 17, 2012 addressing discharges of loans for borrowers who suffer from total and permanent disability, and the Department of Education promulgated final rules on November 1, 2012. Proposed rules relating to other loan issues are expected in 2013, to be effective in 2014. Negotiators failed to reach consensus on proposed regulations related to teacher preparation programs and the awarding of TEACH Grants. The committee disagreed about how, if at all, students' test scores should be used to judge the effectiveness of their teacher's preparation program. Such so-called “value added scores” were promoted by the Department of Education during the negotiations as one way to determine which institutions should be eligible to award TEACH Grants to students in their teacher preparation programs. As the negotiators failed to reach consensus, the Department of Education is now responsible for drafting proposed regulations, to be released at a future date. APUS offers a state-approved educator certification program in West Virginia and would therefore be subject to any regulations that may be promulgated.

On April 25, 2012, the Department of Education announced that it would be publishing a notice regarding its intent to establish a negotiated rulemaking committee to prepare proposed regulations for the Title IV programs. The announcement states that the Department of Education intends to develop proposed regulations designed to prevent fraud and otherwise ensure proper use of Title IV program funds, and to improve and streamline the campus-based Title IV programs. The announcement states that the Department of Education is considering regulatory changes related to the disbursement of Title IV program funds, particularly electronic funds transfers made directly to a student's bank account and available to the student via debit or another bank-provided card. The Department of Education held two public hearings in May 2012. Negotiations were expected to begin in 2012 but to date the Department of Education has not announced negotiated rulemaking teams or a negotiated rulemaking schedule.

Executive Order on Military and Veterans Benefits Programs. On April 27, 2012, President Obama issued an Executive Order, which we refer to as the EO, that directs the Departments of Defense, Veterans Affairs, and Education to establish “Principles of Excellence to strengthen oversight, enforcement, and accountability”, which we refer to as the Principles, in connection with the Post-9/11 GI Bill and the Department of Defense tuition assistance program. The EO requires the Principles to apply to all education institutions that receive funding from military and veterans education benefits programs, and it does not distinguish among not-for-profit, public, and for-profit institutions. The Principles include, for example, disclosure obligations related to program costs, student aid eligibility, estimated loan debt, student outcomes, and education plans and a prohibition on “fraudulent and aggressive recruiting techniques” on and off military installations. The agencies must implement the Principles through various actions, and within 90 days after the date of the EO they must report to the President their progress, including in terms of revisions to regulations, guidance documents, memoranda of understanding, and other policies related to the Post-9/11 GI Bill and DoD tuition assistance. In addition, among other action, the Departments of Defense, Veterans Affairs, and Education are directed to develop a comprehensive strategy to establish service member and veteran student outcome measures that are comparable, to the maximum extent practicable, across military and veterans education benefit programs, and the Department of Education must collect from institutions and publish information on the amount of funding institutions receive from the Post-9/11 GI Bill and the Department of Defense tuition assistance program. The EO also contains requirements related to enforcement of and compliance related to the Principles, including, for example, development of complaint systems and establishment of procedures for program reviews. Because a significant portion of our students use funding from military and veterans benefits programs, any actions that these agencies take could have a significant impact on our business.

The Department of Veterans Affairs requested that each education institution state, by electronic mail sent by August 1, 2012, its intent to comply with the Principles. We notified the Department of Veterans Affairs that APUS intends to make a good faith effort to comply with the EO, subject to clarifying guidance and interpretation by the Departments of Defense, Veteran Affairs and Education and/or the Consumer Financial Protection Bureau. On July 13, 2012, the Department of Education issued guidance on each Principle's meaning. The EO requires the Secretaries of Defense and Veterans Affairs, in consultation with the Secretary of Education and the Director of the Consumer Financial Protection Bureau, to submit a plan to strengthen enforcement and compliance related to the Principles before the end of July 2012. Such plan has not been published. We do not know what further actions the Departments of Defense, Veterans Affairs, and Education will take to implement the Principles.

Consumer Financial Protection Bureau. On August 29, 2012, the Consumer Financial Protection Bureau, or CFPB, submitted a report to the Senate Committee on Banking, Housing, and Urban Affairs, the Senate HELP Committee, the House of Representatives Committee on Financial Services, and the House of Representatives Committee on Education and the Workforce entitled “Private Student Loans.” The report contained specific suggestions for Congressional action to restructure the student lending experience, including possibly requiring institutions to certify that a student is not eligible for any further federal funds before a private loan may be issued to such student. On October 16, 2012, the Consumer Financial Protection Bureau's Ombudsman for private student loan matters issued a report containing recommendations for the Senate Committee on Banking, Housing, and Urban Affairs, the Senate HELP Committee, the House Committee on Financial Services, the House Committee on Education and the Workforce, the Secretary of the Treasury, the Director of the Consumer Financial Protection Bureau, and the Secretary of Education. The report addressed potential reforms to student loan servicing and expansion of loan modification and refinancing options. In addition, on October 18, 2012 the Consumer Financial Protection Bureau released a report entitled “The Next Front? Student Loan Servicing and the Cost to Our Men and Women in Uniform.” The report details the challenges that some service members have encountered when utilizing private and federal student loans. We do not know what steps may be taken by Congress or federal agencies in response to this report, or the report of the majority staff of the HELP Committee, and whether such actions (if any) will have an adverse effect on our business or results of operations. Also, on January 31, 2013, CFPB encouraged institutions of higher education, students, and others to provide information to the CFPB by March 18, 2013 about the financial products and services currently offered to students, and comments on how current and future arrangements between institutions of higher education and financial institutions could be structured in order to promote positive financial decision-making among consumers.

ITEM 1A. RISK FACTORS

Investing in our common stock has a high degree of risk. Before making an investment in our common stock, you should carefully consider the following risks, as well as the other information contained in this annual report, including our consolidated financial statements and related notes and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Any of the risk factors described below could significantly and adversely affect our business, prospects, financial condition, and results of operations. As a result, the trading price of our common stock could decline, and you may lose all or part of your investment.

Risks Related to Our Business

If we are unable to continue our recent revenue and earnings growth, our stock price may decline and we may not have adequate financial resources to execute our business plan.

Our revenue increased 33% from $149.0 million in 2009 to $198.2 million in 2010, 31% from $198.2 million in 2010 to $260.4 million in 2011, and 20% from $260.4 to $313.5 in 2012 primarily due to strong referrals from current students, new student marketing, and the variety and affordability of our program offerings. The same factors that led to the growth in revenues also contributed to our net income improving to $42.3 million in 2012 from $40.8 million in 2011. The rate of revenue growth from 2011 to 2012 was at a slower pace than the rate of growth from 2009 to 2011. As our revenue base has grown, our growth rate percentages have declined, and it may continue to decline. You should not rely on the results of any prior periods as an indication of our future operating performance. If we are unable to maintain adequate revenue and earnings growth, or if investors react negatively to the slowing of our growth rates, the value of our stock price may decline.

Our growth may place a strain on our resources that could adversely affect our systems, controls and operating efficiency.

The growth that we have experienced in the past, as well as any future growth that we experience, may place a significant strain on our resources and increase demands on our management information and reporting systems and financial management controls. We do not have experience scheduling courses and administering programs for more students than our current enrollment, and if growth negatively impacts our ability to do so, the learning experience for our students could be adversely affected, resulting in a higher rate of student attrition and fewer student referrals. We also have limited experience adding to our courses, programs and operations through acquisitions. Future growth will also require continued improvement of our internal controls and systems, particularly those related to complying with federal regulations under the Higher Education Act of 1965, or the Higher Education Act, as administered by the U.S. Department of Education, including as a result of our participation in federal student financial aid programs under Title IV of the Higher Education Act, which we refer to in this annual report as Title IV programs. We have described some of the most significant regulatory risks that apply to us, including those related to Title IV programs, under the heading “Risks Related to the Regulation of our Industry” below. If we are unable to manage our growth or successfully carry out and integrate acquisitions, we may also experience operating inefficiencies that could increase our costs and adversely affect our profitability and results of operations.

We have recently experienced, and may in the future experience to a greater degree, increases in our administrative and technology infrastructure expenses, our exposure to bad debt and unpredictability in enrollment.

Since gaining access to Title IV programs, a significant portion of our growth is attributable to students using Title IV programs. This has led to a change in the mix of students that we serve, which has resulted, and will continue to result, in a need to provide a greater level of services to our students. Our costs and expenses have increased due in part to increased general and administrative expenses related to this shift in student mix and primarily attributable to an increase in expenditures for financial aid processing fees, expenditures for technology required to support the increase in civilian students, and increased bad debt primarily associated with our civilian students. In order to support the number of students we now have and to plan for the future, we also expect that we will make significant investments in our technology infrastructure and financial aid processing capabilities, which from time to time, will result in an increased level of spending, not all of which can be capitalized.

The change in our student mix has also made it harder for us to make long range forecasts about student enrollments. We have had more difficulty forecasting the number of students who will enroll and have noticed a decrease in the predictability of the rate at which we convert leads into enrolled students, which we attribute, in part, to the growth in civilian students, and particularly the growth in civilian students from outside of public service communities.

If we are unable to manage changes in the composition of our student body and control the growth of related expenditures, we may experience operating inefficiencies that could increase our costs and adversely affect our profitability and results of operations.

The ability of military students to enroll in our courses can be impacted by factors that we do not anticipate, which can impact our registrations and make it more difficult for us to accurately forecast expected enrollment.

Beginning with registrations for the third quarter of 2010, we observed that for a period of time the growth of our net course registrations from active duty military students slowed more than we expected. We do not know all of the factors that caused this to occur. We believe that the changes we saw in net course registrations from active duty military students were in part due to increased operations activity and overseas deployments across all branches of the US military, particularly the level of activity in the United States Marine Corps. We believe that increased demands on many active duty military personnel, combined with limited internet access associated with some deployments, impacted the ability of certain active duty military students to pursue higher education in 2010. Due to the variability of military activity and other factors over which we have no control, the difficulty in predicting military enrollments that we encountered in 2010 could continue in the future or become more pronounced. In addition, over the next several years the number of active and reserve military professionals is likely to decrease if, as proposed, the military downsizes its forces incrementally. Any decline in the enrollments, or decline in the growth of enrollments, from active duty military students could have an adverse impact on our total net course registrations and revenues.

Tuition assistance programs offered to United States Armed Forces personnel constituted 38% of our adjusted net course registrations for 2012, and our revenues and number of students would decrease if we are no longer able to receive funds under these tuition assistance programs or tuition assistance is reduced or eliminated.

Service members of the United States Armed Forces are eligible to receive tuition assistance from their branch of the armed forces that they may use to pursue postsecondary degrees. Service members of the United States Armed Forces can use tuition assistance at postsecondary schools that are accredited by accrediting agencies recognized by the U.S. Secretary of Education and that sign a Memorandum of Understanding with the Department of Defense. We rely for a significant portion of our revenues on the tuition assistance programs offered to United States Armed Forces personnel. Our tuition is currently structured so that tuition assistance payments for service members fully cover the service member's per course tuition cost of our undergraduate courses and cover more than 75% of the per course tuition cost of our graduate courses. If we are no longer able to receive tuition assistance payments or the tuition assistance program is reduced or eliminated, our enrollments and revenues would be significantly reduced resulting in a material adverse effect on our results of operations and financial condition.

A recent congressional investigation of DoD tuition assistance programs used for distance education and proprietary institutions and a DoD rulemaking that increases oversight of educational programs offered to active service members could result in legislation that limits in whole or in part our participation in the tuition assistance program. In January 2012, Senators Harkin and Durbin introduced legislation that would modify the Higher Education Act's 90/10 Rule. Under the Higher Education Act, a proprietary institution is prohibited from deriving from Title IV funds, on a cash accounting basis (except for certain institutional loans) for any fiscal year, more than 90% of its revenues (as computed for 90/10 Rule purposes). An institution that derives more than 90% of its cash-basis revenue from Title IV programs for two consecutive fiscal years will be ineligible to participate in Title IV programs for at least two fiscal years. The proposed legislation would decrease the limit to 85% and would count DoD tuition assistance and veterans' education benefits toward that limit. In February 2012, companion bills were introduced in the U.S. Senate and U.S. House of Representatives that would modify the 90/10 Rule to count DoD tuition assistance and veterans' educations benefits toward the 90% limit, along with Title IV programs. Although these changes alone would not have caused American Public University System, or APUS, to be in violation of the rule based upon 2012 revenues, they would reduce the margin of compliance and make APUS more vulnerable to changes in its revenue sources. These changes would also likely reduce competition in the market for military students utilizing DoD tuition assistance and veterans' educations benefits, which may increase the percentage of our student body comprised by such students, increasing the possibility of our non-compliance with the 90/10 Rule, if modified by these proposed changes. See "Risks Related to the Regulation of our Industry" for additional information on these developments.

In October 2011, the Marine Corps announced, and later rescinded, new tuition assistance rules that cut the maximum benefit for its service members from $4,500 per year to $875 per year and reduced the tuition assistance from $250 per credit hour to $175 per credit hour. Although undergraduate tuition assistance levels have been restored to their prior levels with retroactive benefits to affected service members, the Marine Corps has warned that the current levels of funding are not sustainable. The Marine Corps did reduce graduate level tuition assistance from $350 per credit hour to $250 per credit hour, which is consistent with the current tuition assistance payments from the other military services. We anticipate that the other services will also consider potential changes to the tuition assistance program.

DoD is required to submit a report to the Senate and House Armed Services Committees on how to increase the efficiency of tuition assistance program funding, including the impact of changing the program to require service members to pay 25% of their expenses. The report was due June 20, 2012, but has not been published. In addition, in October 2011, DoD announced that while it will maintain the current levels of tuition assistance in the near term, it plans to consider changes as part of a holistic review of the military compensation package. We believe modifications to the tuition assistance program may include a reduced per credit tuition benefit (currently $250), a decrease in the annual cap (currently $4,500), and/or require that service members pay out-of-pocket for a portion of their tuition, among other possible changes.

If tuition assistance payments are reduced, we believe that most service members would be eligible and able to finance out-of-pocket tuition costs resulting from this shortfall using their "Top Up" benefits under the GI Bills, which allow service members to use a portion of their GI Bill benefits while still on active duty. However, we do not know whether in the long-term service members would be willing to use the Top-Up option, or whether the increased administrative process in using the Top-Up option or covering the shortfall through other funding sources would lead to service members deciding not to enroll or enrolling at a slower rate.

We are not able to estimate the effect of future expected changes to the tuition assistance programs or whether the services would impose other criteria in addition to the level of reimbursement that would impact enrollments from service members. We are also not able to estimate the response that our competitors would take to reduced tuition assistance payments or the willingness of service members to use their Top-Up option available to them under their veterans' benefits. In this regard, our competitors, particularly those with larger student populations or a smaller concentration of students from the military, may be better situated to lower the cost of tuition to service members.

If we are no longer able to receive tuition assistance payments or the tuition assistance program is reduced or eliminated, our enrollments and revenues could be significantly reduced, which would result in a material adverse effect on our results of operations and financial condition.

Implementation of Executive Orders by federal agencies may impose additional regulatory burdens upon us and negatively affect our business or results of operations.

On April 27, 2012, President Obama issued an Executive Order, which we refer to as the EO, that directs the Departments of Defense, Veterans Affairs, and Education to establish "Principles of Excellence to strengthen oversight, enforcement, and accountability", which we refer to as the Principles, in connection with the Post-9/11 GI Bill and the DoD tuition assistance program. The EO requires the Principles to apply to all education institutions that receive funding from military and veterans' education benefits programs, and it does not distinguish among not-for-profit, public, and for-profit institutions. The Principles include, for example, disclosure obligations related to program costs, student aid eligibility, estimated loan debt, student outcomes, and education plans, and a prohibition on "fraudulent and aggressive recruiting techniques" on and off military installations. The agencies must implement the Principles through various actions, and within 90 days after the date of the EO they must report to the President their progress, including in terms of revisions to regulations, guidance documents, memoranda of understanding, and other policies related to the Post-9/11 GI Bill and Department of Defense tuition assistance. In addition, among other action, the Departments of Defense, Veterans Affairs, and Education are directed to develop a comprehensive strategy to establish service member and veteran student outcome measures that are comparable, to the maximum extent practicable, across military and veterans education benefit programs, and the Department of Education must collect from institutions and publish information on the amount of funding institutions receive from the Post-9/11 GI Bill and the DoD tuition assistance program. The EO also contains requirements related to enforcement of and compliance related to the Principles, including, for example, development of complaint systems and establishment of procedures for program reviews. Because a significant portion of our students use funding from military and veterans benefits programs, any actions that these agencies take could have a significant impact on our business.

The Department of Veterans Affairs requested that each education institution state, by electronic mail sent by August 1, 2012, its intent to comply with the Principles. We notified the Department of Veterans Affairs that APUS intends to make a good faith effort to comply with EO, subject to clarifying guidance and interpretation by the Departments of Defense, Veteran Affairs, Education and/or the Consumer Financial Protection Bureau. On July 13, 2012, the Department of Education issued guidance on each Principle's meaning. The EO requires the Secretaries of Defense and Veterans Affairs, in consultation with the Secretary of Education and the Director of the Consumer Financial Protection Bureau, to submit a plan to strengthen enforcement and compliance related to the Principles before the end of July 2012. Such plan has not been published. We do not know what further actions the Departments of Defense, Veterans Affairs, and Education will take to implement the Principles.

Strong competition in the postsecondary education market, especially in the online education market, could decrease our market share and increase our cost of acquiring students.

Postsecondary education is highly fragmented and competitive. We compete with traditional public and private two-year and four-year colleges as well as other for-profit schools, particularly those that offer online learning programs. Public and private colleges and universities, as well as other for-profit schools, offer programs similar to those we offer. Public institutions receive substantial government subsidies, and public and private institutions have access to government and foundation grants, tax-deductible contributions and other financial resources generally not available to for-profit schools. Accordingly, public and private institutions may have access to resources that are superior to those in the for-profit sector. In addition, some of our competitors, including both traditional colleges and universities and other for-profit schools, have substantially greater name recognition and financial and other resources than we have, which may enable them to compete more effectively for potential students, particularly in the non-military sector of the market. In the military sector of the market, we believe that for-profit schools may increasingly be seeking to attract military students, including because these schools may see it as helpful in their efforts to comply with the 90/10 Rule, as currently DoD tuition assistance and veterans' education benefits do not count towards the 90% limit.

We expect to face increased competition as a result of new entrants to the online education market, including established colleges and universities that have not previously offered online education programs. We are also continuing to see increasing differentiation between the way in which our competitors are delivering online offerings, which impacts the ability to attract students, facilitate access to education and provide convenience to learners. We believe that in the future many online students will be attracted to institutions in part because of the technology that the institutions offer and the way in which that technology facilitates access to education and learning.

In addition, we face new competition from various emerging non-traditional, credit-bearing and non-credit-bearing education programs, provided by proprietary, not-for-profit and public providers, including massive open online courses offered worldwide without charge by traditional educational institutions and other direct-to-consumer education services, as well as other offerings at low costs to students. These emerging non-traditional programs could also lead to fundamental changes in the way in which higher education is delivered and recognized and the value that is placed on a traditional degree of the type we offer.

We may not be able to compete successfully against current or future competitors and may face competitive pressures that could adversely affect our business or results of operations. We may also face increased competition if our competitors pursue relationships with the military and governmental educational programs with which we already have relationships. These competitive factors could cause our enrollments, revenues and profitability to decrease significantly.

If we are unable to update and expand the content of existing programs and develop new programs and specializations on a timely basis and in a cost-effective manner, our future growth may be impaired.

The updates and expansions of our existing programs and the development of new programs and specializations may not be accepted by existing or prospective students or employers. If we cannot respond to changes in market requirements, our business may be adversely affected. Even if we are able to develop acceptable new programs, we may not be able to introduce these new programs as quickly as students require or as quickly as our competitors introduce competing programs. To offer a new academic program, we may be required to obtain appropriate federal, state and accrediting agency approvals, which may be conditioned or delayed in a manner that could significantly affect our growth plans. On June 30, 2012, the U.S. District Court for the District of Columbia vacated the regulations requiring the U.S. Department of Education to receive notice of (and possibly approve) any new program that prepares students for gainful employment, which for APUS includes most of its programs. However, pre-existing regulations require institutions to obtain Department of Education approval for new programs under certain circumstances, and it is unclear whether the Department of Education will repromulgate the vacated regulation in a form that can withstand challenge. See "Risks Related to the Regulation of our Industry" for additional information on program approval requirements. If we are unable to respond adequately to changes in market requirements due to financial constraints, regulatory limitations or other factors, our ability to attract and retain students could be impaired and our financial results could suffer.

Establishing new academic programs or modifying existing programs requires us to make investments in management, incur marketing expenses and reallocate other resources. We may have limited experience with the courses in new areas and may need to modify our systems and strategy or enter into arrangements with other institutions to provide new programs effectively and profitably. If we are unable to increase the number of students, or offer new programs in a cost-effective manner, or are otherwise unable to manage effectively the operations of newly established academic programs, our results of operations and financial condition could be adversely affected.

If we do not have adequate continued personal referrals and marketing and advertising programs that are effective in developing awareness among, attracting and retaining new students, our financial performance in the future would suffer.

Building awareness of AMU and APU and the programs we offer among potential students is critical to our ability to attract new students. In order to maintain and increase our revenues and profits, we must continue to attract new students in a cost-effective manner and these students must remain active in our programs. In addition, because we experience declines in our student population as a result of graduation, transfers to other academic institutions, military deployments and other reasons, in order to grow we need to first attract sufficient students to replace those that have left AMU or APU. Beginning in 2009 and continuing into 2012, we increased the amounts spent on marketing and advertising, and we anticipate this trend to continue, particularly as a result of our attempts to attract and retain students from non-military market sectors. We use marketing tools such as the Internet, exhibits at conferences, and print media advertising to promote our schools and programs, and we also began using more traditional media advertising beginning in 2011 and continuing through 2012. Additionally, we rely on the general reputation of AMU and APU and referrals from current students, alumni and educational service officers in the United States Armed Forces as a source of new students. Some of the factors that could prevent us from successfully advertising and marketing our programs and from successfully enrolling and retaining students in our programs include:

the emergence of more successful competitors and tuition-free or other low-cost courses;

factors related to our marketing, including the costs of Internet advertising and broad-based branding campaigns;

limits on our ability to attract and retain effective employees because of the new incentive payment rule (see “Risks Related to the Regulation of our Industry”);

performance problems with our online systems;

failure to maintain accreditation;

student dissatisfaction with our services and programs;

failure to develop a message or image that resonates well within non-military sectors of the market;

adverse publicity regarding us, our competitors or online or for-profit education generally;

adverse developments in our relationship with military educational service officers;

a decline in the acceptance of online education; and

a decrease in the perceived or actual economic benefits that students derive from our programs.

On January 10, 2013, the President signed Improving Transparency of Education Opportunities for Veterans Act, which requires the Secretary of the Department of Veterans Affairs to develop a policy to improve outreach and transparency to service members and veterans by providing information about institutions of higher education, including a centralized mechanism to publish feedback from students and state approving agencies about each institution's quality of instruction, recruiting practices, and placement of graduates. Although the law permits us to verify the feedback and address any issues that we might identify with such feedback before it is published, it is unclear whether the feedback's substance or presentation will negatively affect our ability to attract and retain students. The Department of Veterans Affairs may promulgate regulations to implement the provisions. In addition, the Department of Education began publishing a “College Scorecard” on February 13, 2013, which allows students to compare institutions based on data such as potential earnings and average student-loan debt. It is unclear how students will use this tool, and whether it will negatively affect our ability to attract and retain students.

To continue to grow our enrollment, we expect to continue to increase the amounts that we spend on marketing and advertising as our historical approach to marketing and advertising may not be able to sustain meaningful growth rates. However, because we are smaller than most of our competitors and because our tuition is generally lower, we have fewer funds available to spend on marketing and advertising than they do. Furthermore, our success using marketing approaches that are relatively new to us has led to students that we believe do not perform as well as the students that our historical approach has attained. Accordingly, we may find it increasingly difficult to continue to compete and grow our enrollments.

If we are unable to continue to develop awareness of AMU and APU and the programs we offer, and to enroll and retain students in both military and non-military market sectors, our enrollments would suffer and our ability to increase revenues and maintain profitability would be significantly impaired.

We have limited experience in making investments in other entities, and any such investments may not result in strategic benefits for us or could expose us to other risks.

In 2012, we made an investment in NWHW Holdings, Inc., or NWHW Holdings, that is intended to result in certain strategic benefits to the Company. To assist us in achieving elements of our growth strategy or to further develop our business capabilities, from time to time we will consider and may pursue strategic investments and acquisitions. This could include, among other things, investments in, partnerships or joint ventures with, or the acquisition of other schools, service providers or education technology related companies, among other types of entities. Historically, however, we have not made debt or equity investments in other entities, and investing in another entity requires expertise in evaluating another entity's business and identifying strategic benefits of a potential investment in such entity, among other expertise. These types of investments involve significant challenges and risks including that the investment does not advance our business strategy, that it has an adverse effect on our results of operations, that we do not realize a satisfactory return on our investment, that we acquire unknown liabilities, or that management's attention is diverted from our core business. These events could harm our operating results or financial condition. Any investments in other entities may also subject us to the operating and financial risks of such entities, and we rely on the internal controls and financial reporting controls of such entities.

Investments in other entities in which we do not have sole control, such as our investment in NWHW Holdings, present additional risks. In a minority investment, we would not have the ability to control the policies, management or affairs of the entity in which we would be investing. The interests of persons who control these entities may differ from our interests, and they may cause such entities to take actions that are not in our best interest, and we may become involved in disputes with such persons. Our inability to control entities in which we may make investments could negatively affect our ability to realize the strategic benefits of a non-controlling investment.

System disruptions and security breaches to our online computer networks could negatively impact our ability to generate revenue and damage our reputation, limiting our ability to attract and retain students.

The performance and reliability of our technology infrastructure is critical to our reputation and ability to attract and retain students. Any system error or failure, or a sudden and significant increase in bandwidth usage, could result in the unavailability of our online classroom, damaging our ability to generate revenue. Our technology infrastructure could be vulnerable to interruption or malfunction due to events beyond our control, including natural disasters, terrorist activities and telecommunications failures.

Our systems, particularly those related to Partnership At a Distance™, or PAD, have been predominantly developed in-house, with limited support from outside vendors. We are continuously working on upgrades to PAD, and our employees continue to devote substantial time to its development. To the extent that we face problems with the PAD system, we may not have the capacity to address the problems with our internal capability, and we may not be able to identify outside contractors with expertise relevant to our custom system. Any computer system error or failure, regardless of cause, could result in a substantial outage that materially disrupts our operations. Not all of our critical systems are protected by a validated formal disaster recovery plan and redundant disaster recovery infrastructure at a geographically remote data center. We are currently executing our plan to implement disaster recovery infrastructure for our remaining critical systems to allow timely recovery from catastrophic failure. For those systems not yet protected, a catastrophic failure or unavailability for any reason of our principal data center may require us to replicate the function of this data center at our existing remote data facility or elsewhere, and could result in the loss of data. An event such as this may require service restoration activities that could take up to several weeks to complete.

Any failure of our online classroom system could also prevent students from accessing their courses. Any interruption to our technology infrastructure could have a material adverse effect on our ability to attract and retain students and could require us to incur additional expenses to correct or mitigate the interruption.

Our computer networks may also be vulnerable to unauthorized access, computer hackers, computer viruses and other security problems. A user who circumvents security measures could misappropriate proprietary information, personal information about our students or cause interruptions or malfunctions in operations. As a result, we may be required to expend significant resources to protect against the threat of these security breaches or to alleviate problems caused by these breaches. We engage multiple security assessment providers on a periodic basis to review and assess our security. We utilize this information to audit ourselves to ensure that we are continually monitoring the security of our technology infrastructure. However, we cannot assure you that these security assessments and audits will protect our computer networks against the threat of security breaches. Any of these events could have a material adverse effect on our business, financial condition or results of operations. We maintain a limited amount of business disruption insurance that may cover certain types of disruptions. However, there can be no assurance that insurance proceeds, if available, would be adequate to compensate us for damages sustained due to these disruptions.

System disruptions to our online classroom and technology infrastructure could negatively impact our ability to generate revenue and damage our reputation, limiting our ability to attract and retain students.

Historically, our online classroom employed the Educator™ learning management system pursuant to a license from Ucompass.com, Inc. We determined that it was in our long-term best interest to transition to a new online classroom that allows us to integrate additional technologies and resources, and in 2010 we began the migration to the Sakai Collaboration and Learning Environment (CLE), an open-source Learning Management System, as the foundational software for our online classroom. Our online classroom is central to our operations, and the process of switching to Sakai CLE was complicated and time consuming, involving customization and integration with the rest of our technology infrastructure. The migration was completed in early September 2011. Shortly after the completion of the migration, we experienced periods of unplanned downtime in our online classroom during periods of peak utilization. We believe that in mid-October 2011 we identified the cause of this downtime and took appropriate steps to mitigate the problem. However, we cannot be certain that similar problems will not occur in the future.

While there are reportedly more than 350 educational institutions around the world using Sakai CLE to support teaching, learning, research and collaboration, we believe that of the institutions using Sakai CLE, very few, if any, have a larger number of concurrent users than we do. This means that there are a limited number of other institutions with whom we can compare best practices for use in similar circumstances to ours. Furthermore, to the extent that we face problems with the online classroom in the future, we may not have the ability to address the problems adequately with internal resources, particularly given our limited history using the software, and we may not be able to identify outside contractors with expertise relevant to our customized system.

The performance and reliability of our online classroom and technology infrastructure is critical to our reputation and ability to attract and retain students. Any system error or failure, or a sudden and significant increase in bandwidth usage, could result in the unavailability of our online classroom, preventing students from accessing their courses and damaging our ability to generate revenue. Any significant or ongoing interruption to our technology infrastructure could have a material adverse effect on our results of operations and could require us to incur additional expenses to correct or mitigate the interruption.

Any of the foregoing problems could result in an adverse impact on our operations, damage to our reputation and limits on our ability to attract and retain students.

The personal information that we collect may be vulnerable to breach, theft or loss that could adversely affect our reputation and operations.

Possession and use of personal information in our operations subjects us to risks and costs that could harm our business. We collect, use and retain large amounts of personal information regarding our students and their families, including social security numbers, tax return information, personal and family financial data and credit card numbers. Also, we collect and maintain personal information of our employees in the ordinary course of our business. Some of this personal information is held and managed by certain of our vendors. Although we use security and business controls to limit access and use of personal information, a third party may be able to circumvent those security and business controls, which could result in a breach of student or employee privacy. In addition, errors in the storage, use or transmission of personal information could result in a breach of student or employee privacy, and the increased availability and use of mobile data devices by our employees and students increases the risk of unintentional disclosure of personal information. Possession and use of personal information in our operations also subjects us to legislative and regulatory burdens that could require notification of data breaches and restrict our use of personal information. We cannot ensure that a breach, loss or theft of personal information will not occur. A breach, theft or loss of personal information regarding our students and their families or our employees that is held by us or our vendors could have a material adverse effect on our reputation and results of operations and result in liability under state and federal privacy statutes and legal actions by state attorneys, general and private litigants, and any of which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Future growth or increased technology demands will require continued investment of capital, time and resources to develop and update our technology and if we are unable to increase the capacity of our resources appropriately, our ability to handle growth, our ability to attract or retain students and our financial condition and results of operations could be adversely affected.

Our rate of growth and expectations for the future require us to increase the capacity and capabilities of our technology infrastructure. Increasing the capacity and capabilities of our technology infrastructure will require us to invest capital, time and resources, which we expect from time to time will lead to increased spending on technology infrastructure. There is no assurance that even with sufficient investment our systems will be scalable to accommodate future growth.

We may also need to invest capital, time and resources to update our technology in response to competitive pressures or changes in the marketplace, including the technological preferences of our students and prospective students. For example, students and prospective students seeking to access our online classroom and related administrative infrastructure through devices such as tablets and mobile telephones, rather than traditional desktop and laptop computers, may find our interface difficult to navigate or inoperable in whole or part. As a result, prospective students may be discouraged from enrolling in our courses, and current students may be discouraged from completing academic and administrative tasks without assistance.

Even with sufficient investment, our resources may become impaired or obsolete. . If we are unable to increase the capacity of our resources or update our resources appropriately, our ability to handle growth, our ability to attract or retain students, and our financial condition and results of operations could be adversely affected. Similarly, even if we are able to increase the capacity of our resources and update our resources appropriately, our financial condition and results of operations could be adversely affected by an increased level of spending.

The loss of any key member of our management team may impair our ability to operate effectively and may harm our business.

Our success depends largely upon the continued services of our executive officers and other key management and technical personnel. The loss of one or more members of our management team could harm our business. Except for the employment agreements we have with Dr. Boston, our President and Chief Executive Officer, Dr. Powell, our Executive Vice President and Provost, Dr. van Wyk, our Executive Vice President and Chief Operations Officer, and Mr. Wilkins, our Executive Vice President and Chief Financial Officer, we do not have employment agreements with any of our other executive officers or key personnel.

If we are unable to attract and retain management, faculty, administrators and skilled personnel, our business and growth prospects could be severely harmed.

To execute our growth strategy, we must attract and retain highly qualified management, faculty, administrators and skilled personnel. Competition for hiring these individuals is intense, especially with regard to faculty in specialized areas. Our growth places constant demands on us to find qualified individuals across all levels of our institution from our most senior managers down throughout the organization. If we fail to attract new management, faculty, administrators or skilled personnel or fail to retain and motivate our existing management, faculty, administrators and skilled personnel, our business and growth prospects could be severely harmed.

If we fail to maintain adequate systems and processes to detect and prevent fraudulent activity in student enrollment and financial aid, we may lose our ability to participate in Title IV programs or Department of Defense tuition assistance programs or have our participation in the Title IV programs conditioned or limited.

We have been the target of fraudulent activity by outside parties with respect to student enrollment and student financial aid programs, and as we continue to grow we may be susceptible to an increased risk of such activities. The potential for outside parties to perpetrate fraud in connection with the award and disbursement of Title IV program funds by APUS, including as a result of identity theft, may be heightened due to our nature as an online education provider and our relatively low tuition. We must maintain systems and processes to identify and prevent fraudulent applications for enrollment and financial aid. We cannot be certain that our systems and processes will continue to be adequate in the face of increasingly sophisticated fraud schemes or that we will be able to expand such systems and processes at a pace consistent with our growth.

Grants and loans to students under the federal government's Title IV programs are primarily awarded on the basis of financial need, generally defined as the difference between the cost of attending the institution and the amount a student can be expected to contribute to that cost. In order to account for living expenses and other costs that our students may reasonably incur in the context of pursuing a degree or certificate, the cost of attending APUS is an amount that exceeds the cost of our tuition. While some students elect to receive grants and loans that cover only the cost of tuition, others elect to receive amounts up to the full cost of attendance. When APUS receives Title IV funds from the federal government on a student's behalf, it credits those funds to the student's account. If a student has elected to receive funds in excess of the cost of tuition and fees, a Title IV credit balance occurs, and APUS must pay that credit balance to the student unless the student has authorized APUS to hold the credit balance or take other permissible action with respect to the credit balance. The availability of Title IV funds, including the Title IV credit balance payment, is an important part of enabling some students to pursue a degree or certificate. However, some individuals seek to take advantage of the availability of Title IV funds by enrolling for the purpose of obtaining such funds. On September 26, 2011, the Department of Education's Inspector General released a report about an increasing number of cases involving large, loosely affiliated groups of individuals, so-called "fraud rings", who conspire to defraud the Title IV programs through enrollment in distance education programs. These fraud rings are taking advantage of the availability of Title IV credit balance payments where the cost of attendance exceeds the cost of tuition and fees. We have been the target of fraudulent activity by individuals and groups with respect to student enrollment and the Title IV programs, and given our continued growth and status as an online education provider and our relatively low tuition, we believe that we will increasingly be subject to such activities. We must maintain systems and processes to identify and prevent fraudulent applications for enrollment and Title IV aid. We cannot be certain that our systems and processes will be adequate in the face of increasing and increasingly sophisticated fraud schemes or that we will be able to expand such systems and processes at a pace consistent with our growth.

In addition to those who enroll or attempt to enroll solely to obtain Title IV funds, some students who might not otherwise pursue a degree or certificate are attracted to enroll because of the availability of Title IV funds and economic hardships resulting from today’s economic climate. We believe these students may be more likely than other students to cease pursuing a degree or certificate due to other factors, such as becoming employed or not having the level of commitment necessary to complete successfully the required coursework.

As a result of all of the above factors, the growth in our enrollments reflects some students who will not persist as students. We have also been the target of fraudulent activities by outside parties with respect to student enrollment and Title IV programs, and as we continue to grow, we may be susceptible to an increase of such activities. We are not able to estimate the number of students who fall into these enrollment categories, and we are not able to estimate the impact on our enrollments over time, or any additional impact that this could have on our exposure to bad debt or the number of our students who default on their Title IV student loans.

The Department of Education requires institutions that participate in Title IV programs to refer to the Office of the Inspector General of the Department of Education credible information about fraud or other illegal conduct involving Title IV programs, and in the past we have referred to the Office of the Inspector General information with respect to potential fraud by applicants. If the systems and processes that we have established to detect and prevent fraud are inadequate, or our cohort default rates exceed specified levels or we otherwise do not have procedures in place for safeguarding federal funds, the Department of Education may find that we do not satisfy its “administrative capability” requirements. This could result in our being limited in our access to, or our losing, Title IV program funding, which would limit our potential for growth outside the military sector and adversely affect our enrollment, revenues, and results of operations. In addition, our ability to participate in Title IV programs and the tuition assistance programs of the United States Armed Forces is conditioned on our maintaining accreditation by an accrediting agency that is recognized by the Secretary of Education. Any significant failure to detect adequately fraudulent activity related to student enrollment and financial aid could cause us to fail to meet our accrediting agencies’ standards. Furthermore, under the Higher Education Opportunity Act, accrediting agencies that evaluate institutions that offer distance learning programs like ours must require such institutions to have processes through which the institution establishes that a student who registers for a distance education program is the same student who participates in and receives credit for the program. Failure to meet our accrediting agencies’ standards could result in the loss of accreditation at the discretion of our accrediting agencies, which could result in a loss of our eligibility to participate in Title IV programs and the tuition assistance programs of the United States Armed Forces.

On April 25, 2012, the Department of Education announced that it would publish a notice regarding its intent to establish a negotiated rulemaking committee to prepare proposed regulations for the Title IV programs. The announcement states that the Department of Education intends to develop proposed regulations designed to prevent fraud and otherwise ensure proper use of Title IV program funds, and to improve and streamline the campus-based Title IV programs. The announcement states that the Department of Education is considering regulatory changes related to the disbursement of Title IV program funds, particularly electronic funds transfers made directly to a student's bank account and available to the student via debit or another bank-provided card. The Department of Education held two public hearings in May 2012. Negotiations were expected to begin in 2012 but to date the Department of Education has not announced negotiated rulemaking teams or a negotiated rulemaking schedule. New regulations could affect the manner in which we do business, increase our cost of doing business, or have a material adverse effect on our business, financial condition, results of operations and cash flows.

The protection of our operations through exclusive proprietary rights and intellectual property is limited, and we encounter disputes from time to time relating to our use of intellectual property of third parties, any of which could harm our operations and prospects.

In the ordinary course of our business, we develop intellectual property of many kinds that is or will be the subject of copyright, trademark, service mark, patent, trade secret, or other protections. This intellectual property includes but is not limited to course materials, business know-how, software and internal processes and procedures developed to respond to the requirements of operating and various education regulatory agencies. We rely on a combination of copyrights, trademarks, service marks, trade secrets, domain names, agreements, and registrations to protect our intellectual property. We rely on service mark and trademark protection in the United States and select foreign jurisdictions to protect our rights to various marks, including “AMERICAN MILITARY UNIVERSITY,” “AMERICAN PUBLIC UNIVERSITY,” “AMERICAN PUBLIC UNIVERSITY SYSTEM,” "Ready when you are." "RESPECTED. AFFORDABLE. ONLINE." and “EDUCATING THOSE WHO SERVE,” as well as distinctive logos and other marks associated with our services. We rely on agreements under which we obtain rights to use course content developed by faculty members and other third party content experts. We cannot assure you that the measures that we take will be adequate or that we have secured, or will be able to secure, appropriate protections for all of our proprietary rights in the United States or select foreign jurisdictions, or that third parties will not infringe upon or violate our proprietary rights. Despite our efforts to protect these rights, unauthorized third parties may attempt to duplicate or copy the proprietary aspects of our curricula, online resource material, other content, software and technology, and offer competing programs and/or services to ours.

In particular, third parties may attempt to develop competing programs or services or duplicate or copy aspects of our curriculum, online resource material, quality management, systems and other proprietary content. Any such attempt, if successful, could adversely affect our business. Protecting these types of intellectual property rights can be difficult, particularly as it relates to the development by our competitors of competing courses and programs. In July 2011, a complaint for a declaratory judgment was commenced against us seeking a judicial declaration that the plaintiff did not infringe certain of our trademark rights. While we believe that matter was favorably resolved because the third party ceased to use certain marks, we cannot be certain that other third parties will not infringe our trademark or other intellectual property rights in the future or that the rights we believe that we have to our significant trademarks and other intellectual property rights will be found to be enforceable.

We may encounter disputes from time to time over rights and obligations concerning intellectual property, and we may not prevail in these disputes. We believe that some third parties are becoming more aggressive in pursuing enforcement of their intellectual property portfolios, and these third parties or others may raise a claim against us alleging an infringement or violation of the intellectual property of that third party. In July 2006, we settled a dispute with another institution regarding the use of certain marks that allowed us to continue to use the marks at issue, but we may not be able to favorably resolve future disputes. Some third party intellectual property rights may be extremely broad, and it may not be possible for us to conduct our operations in such a way as to avoid those intellectual property rights. Any such intellectual property claim could subject us to costly litigation and impose a significant strain on our financial resources and management personnel regardless of whether such claim has merit. Our general liability and cyber liability insurance may not cover potential claims of this type adequately or at all, and we may be required to alter the content of our classes or pay monetary damages, which may be significant.

We may incur liability for the unauthorized duplication or distribution of class materials posted online for class discussions.

In some instances, our faculty members or our students may post various articles or other third party content on class discussion boards. We may incur liability for the unauthorized duplication or distribution of this material posted online for class discussions. Third parties may raise claims against us for the unauthorized duplication of this material. Any such claims could subject us to costly litigation and impose a significant strain on our financial resources and management personnel regardless of whether the claims have merit. Our faculty members or students could also post classified material on class discussion boards, which could expose us to civil and criminal liability and harm our reputation and relationships with members of the military and government. Our general liability insurance may not cover potential claims of this type adequately or at all, and we may be required to alter the content of our courses or pay monetary damages.

Because we are an exclusively online provider of education, we are entirely dependent on continued growth and acceptance of exclusively online education and, if the recognition by students and employers of the value of online education does not continue to grow, our ability to grow our business could be adversely impacted.

We believe that continued growth in online education will be largely dependent on additional students and employers recognizing the value of degrees from online institutions. If students and employers are not convinced that online schools are an acceptable alternative to traditional schools or that an online education provides value, or if growth in the market penetration of exclusively online education slows, growth in the industry and our business could be adversely affected. Because our business model is based on online education, if the acceptance of online education does not grow, our ability to continue to grow our business and our financial condition and results of operations could be materially adversely affected.

If we do not maintain continued strong relationships with various military bases and educational service officers, and if we are unable to expand our use of articulation agreements, our future growth may be impaired.

We have non-exclusive articulation agreements or memoranda of understanding with various educational institutions of the United States Armed Forces and other governmental education programs. Articulation agreements and memoranda of understanding are agreements pursuant to which we agree to award academic credits toward our degrees for learning in educational programs offered by others. Additionally, we rely on relationships with educational service offices on military bases and base education officers to distribute our information to interested service members. If our relationships with educational service offices or base education counselors deteriorate or end, our efforts to recruit students from that base will be impaired. If our articulation agreements and memoranda of understanding are eliminated, or if our relationships with educational service offices or base education counselors deteriorate, this could materially and adversely affect our revenues and results of operations.

In August 2010, DoD issued a proposed rule that would increase oversight of educational programs offered to active service members. The final rule, published December 7, 2012 and effective January 7, 2013, requires all institutions to sign a Memorandum of Understanding, or MOU, by March 1, 2013. The MOU outlines certain commitments and agreements between the institution and DoD prior to accepting funds under the tuition assistance program. We have entered into a MOU with DOD. However the requirement to enter into a MOU, and the related increased focus by the DoD on relationships and oversight of educational providers could lead to changes in the nature of our relationships with military bases and educational service officers (including possibly needing to enter into separate installation MOUs and obtain permission to counsel students in person on the installation), which could be adverse in nature. At least one installation has banned educational providers from directly counseling potential students on the installation. Additional installations may determine to institute similar bans, which could materially and adversely affect our revenues and results of operations.

The United States Armed Forces has in the past and may in the future approve programs and initiatives to provide additional educational opportunities to service members, and these programs and initiatives may not include participation by us. We cannot predict the impact of these announcements, programs, or initiatives on us, but given our dependence on students from the armed forces, our net course registrations, and results of operations could be materially adversely affected by such announcements, programs, and initiatives.

Government regulations relating to the Internet could increase our cost of doing business, affect our ability to grow or otherwise have a material adverse effect on our business.

The increasing popularity and use of the Internet and other online services have led and may lead to the adoption of new laws and regulatory practices in the United States or foreign countries and to new interpretations of existing laws and regulations. These new laws and interpretations may relate to issues such as online privacy, copyrights, trademarks, and service marks, sales taxes, fair business practices, and the requirement that online education institutions qualify to do business as foreign corporations or be licensed in one or more jurisdictions where they have no physical location or other presence. New laws, regulations, or interpretations related to doing business over the Internet could increase our costs and materially and adversely affect our enrollments, revenues, and results of operations.

Risks Related to the Regulation of Our Industry

If we fail to comply with the extensive regulatory requirements for our business, we could face penalties and significant restrictions on our operations, including loss of access to federal tuition assistance programs for members of the United States Armed Forces and federal loans and grants for our students.

We are subject to extensive regulation by (1) the federal government through the U.S. Department of Education and under the Higher Education Act, the Department of Defense and the Department of Veterans Affairs, (2) state regulatory bodies, and (3) accrediting agencies recognized by the U.S. Secretary of Education. The regulations, standards and policies of these agencies cover the vast majority of our operations, including our educational programs, facilities, instructional, and administrative staff, administrative procedures, marketing, recruiting, financial operations, and financial condition. These regulatory requirements can also affect our ability to add new or expand existing educational programs and to change our corporate structure and ownership.

Institutions of higher education that grant degrees, diplomas, or certificates must be authorized by an appropriate state education agency or agencies. In addition, in certain states as a condition of continued authorization to grant degrees and other credentials and in order to participate in various federal programs, including tuition assistance programs of the United States Armed Forces, a school must be accredited by an accrediting agency recognized by the Secretary of

Education. Accreditation is a non-governmental process through which an institution submits to qualitative review by an organization of peer institutions, based on the standards of the accrediting agency and the stated aims and purposes of the institution. The Higher Education Act requires accrediting agencies recognized by the Department of Education to review and monitor many aspects of an institution's operations and to take appropriate action when the institution fails to comply with the accrediting agency's standards.

Our operations are also subject to regulation due to our participation in Title IV programs. Title IV programs, which are administered by the Department of Education, include loans made directly to students by the Department of Education. Title IV programs also include several grant programs for students with economic need as determined in accordance with the Higher Education Act and Department of Education regulations. To participate in Title IV programs, a school must receive and maintain authorization by the appropriate state education agencies, be accredited by an accrediting agency recognized by the Secretary of Education, and be certified as an eligible institution by the Department of Education. Our growth strategy is partly dependent on enrolling more students who are attracted to us because of our continued participation in these programs.

The regulations, standards, and policies of the Department of Education, state education agencies, and our accrediting agencies change frequently. Recent and pending changes in, or new interpretations of, applicable laws, regulations, standards, or policies, or our noncompliance with any applicable laws, regulations, standards, or policies, could have a material adverse effect on our accreditation, authorization to operate in various states, activities, receipt of funds under tuition assistance programs of the United States Armed Forces, our ability to participate in Title IV programs, or costs of doing business. Furthermore, findings of noncompliance with these laws, regulations, standards, and policies also could result in our being required to pay monetary damages, or being subjected to fines, penalties, injunctions, limitations on our operations, termination of our ability to grant degrees, revocation of our accreditation, restrictions on our access to Title IV program funds, or other censure that could have a material adverse effect on our business.

If we fail to maintain our institutional accreditation, we would lose our ability to participate in the tuition assistance programs of the United States Armed Forces and also to participate in Title IV programs.

APUS is accredited by The Higher Learning Commission of the North Central Association of Colleges and Schools, one of six regional accrediting agencies recognized by the Secretary of Education. Accreditation by an accrediting agency that is recognized by the Secretary of Education is required for participation in the tuition assistance programs of the United States Armed Forces. In 2012, we derived approximately 38% of our revenue from net course registrations from these tuition assistance programs. Accreditation by an accrediting agency that is recognized by the Secretary of Education for Title IV purposes is also required for an institution to become and remain eligible to participate in Title IV programs. APUS achieved regional accreditation from The Higher Learning Commission in 2006. We were also accredited by the Accrediting Commission of the Distance Education and Training Council, or DETC, until April 30, 2012, when we voluntarily withdrew our accreditation. We have always identified The Higher Learning Commission as our primary accreditor for Title IV purposes. Therefore, our withdrawal of DETC accreditation did not affect our Title IV participation.

The Higher Learning Commission may impose restrictions on our accreditation or may terminate our accreditation. To remain accredited APUS must continuously meet certain criteria and standards relating to, among other things, performance, governance, institutional integrity, educational quality, faculty, administrative capability, resources, and financial stability. Failure to meet any of these criteria or standards could result in the loss of accreditation at The Higher Learning Commission. Loss of accreditation would, among other things, render our students and us ineligible to participate in the tuition assistance programs of the United States Armed Forces or Title IV programs and have a material adverse effect on our enrollments, revenues, and results of operations.

Our student enrollments could decline if we fail to maintain any of our accreditations.

Accreditation by The Higher Learning Commission is an important attribute of our university system. Colleges and universities depend, in part, on accreditation in evaluating transfers of credit and applications to graduate schools. Employers rely on the accredited status of institutions when evaluating a candidate’s credentials, and students and corporate and government sponsors under tuition reimbursement programs look to accreditation for assurance that an institution maintains quality educational standards. In addition, certain of our individual programs are accredited by specialized accrediting agencies. If we fail to satisfy the standards of any of those specialized accrediting agencies, we could lose the specialized accreditation for the affected programs, which could result in materially reduced student enrollments in those programs and have a material adverse effect on us.

Increased scrutiny of accrediting agencies by the Secretary of Education and the U.S. Congress may result in increased scrutiny of institutions, particularly proprietary institutions, by accrediting agencies, and if our institutional accrediting agency loses its ability to serve as an accrediting agency for Title IV program purposes, we may lose our ability to participate in Title IV programs.

In November and December 2009, the Department of Education's Office of the Inspector General, or OIG, issued reports criticizing three regional accreditors – Middle States Commission on Higher Education, the Southern Association of Colleges and Schools, and The Higher Learning Commission – for failing to define both program length and credit hours. OIG, in an unusual action, recommended that the Department of Education consider limiting, suspending, or terminating The Higher Learning Commission's recognition as an accreditor for purposes of determining institutional eligibility to participate in Title IV programs. In response, Department of Education staff conducted a special review of The Higher Learning Commission and required The Higher Learning Commission to accept a corrective action plan. The Higher Learning Commission received additional scrutiny in June 2010 during a House Education and Labor Committee hearing focused on OIG's findings with regard to credit hour policies.

In December 2010, the National Advisory Committee on Institutional Quality and Integrity, or NACIQI, the panel charged with advising the Department of Education on whether to recognize accrediting agencies for Title IV purposes, reviewed The Higher Learning Commission's status as a recognized accrediting agency. Based on The Higher Learning Commission's response to the Department's special review and a December 2008 interim report (which responded to a 2007 NACIQI review unrelated to the OIG findings), NACIQI voted to continue the Higher Learning Commission's recognition as an accrediting agency but also ordered the agency to submit an additional compliance report in one year. At its December 2011 meeting, NACIQI characterized The Higher Learning Commission's report as "informational" and noted that no vote was to be taken on it. We are currently unaware of what further action NACIQI might take with respect to The Higher Learning Commission and its compliance report. NACIQI is next scheduled to review The Higher Learning Commission for recognition purposes in spring 2013.

Scrutiny of accrediting agencies and their accreditation of proprietary institutions is likely to continue. For example, The Higher Learning Commission received further scrutiny in March 2011 during a Senate HELP Committee hearing focused on accreditation of proprietary institutions. If the Department of Education were to limit, suspend, or terminate The Higher Learning Commission's recognition, we would lose our ability to participate in the Title IV programs. Our students and our institution would be ineligible to participate in the Title IV programs, and such consequence would have a material adverse effect on enrollments, revenues, and results of operations. In addition, increased scrutiny of accrediting agencies by the Secretary of Education in connection with the Department of Education's recognition process may result in increased scrutiny of institutions by accrediting agencies.

Furthermore, because the for-profit education sector is growing at such a rapid pace, it is possible that accrediting bodies will respond to that growth by adopting additional criteria, standards, and policies that are intended to monitor, regulate, or limit the growth of for-profit institutions like us. For example, in June 2009 and February 2010, The Higher Learning Commission adopted new policies related to institutional control, structure, and organization. Part of The Higher Learning Commission's rationale for these changes was to better define the range of its oversight of transactions related to change of ownership at institutions. The new policies extend The Higher Learning Commission's oversight to transactions that change, or have the potential to change, the control of an institution or its fundamental structure and organization. Under the new policies, The Higher Learning Commission also now extends its oversight to defined changes that occur in a parent or controlling entity, and not necessarily in the institution itself. Actions by, or relating to, an accredited institution, including a significant acquisition of another institution, significant changes in board composition or organizational documents, and accumulations by one stockholder of greater than 25% of the capital stock, could open up an accredited institution to additional reviews by The Higher Learning Commission and possible change from an accredited status to candidate status, which enhances the risks of these types of actions. In particular, the change from accredited status to candidate status could adversely impact an institution's ability to participate in Title IV programs. For-profit institutions may also be less attractive acquisition candidates because The Higher Learning Commission has enhanced its scrutiny of change in control transactions, obtained the explicit ability to move an institution from accredited status to candidate status, and will be examining more closely entities that own accredited institutions. If The Higher Learning Commission determines that a change required its prior approval but an institution failed to obtain such approval, The Higher Learning Commission may consider withdrawing accreditation.

New and anticipated regulations published by the U.S. Department of Education could result in regulatory changes that may materially and adversely affect our business.

On October 29, 2010, the Department of Education published final regulations concerning certain institutional eligibility issues (such as state authorization for postsecondary education institutions), definitional issues (such as the definition of "credit hour" for certain eligibility and other purposes), student eligibility issues (including the validity of high school diplomas), and other Title IV provisions (such as gainful employment program reporting and disclosure, incentive payment and misrepresentation), as well as final regulations to establish a process under which an institution applies for approval to offer an educational program that prepares students for gainful employment in a recognized occupation. These final regulations were generally effective July 1, 2011. On June 13, 2011, the Department of Education published final regulations on metrics for gainful employment programs effective July 1, 2012. Collectively, the October 29 and June 13 regulations are referred to as the "program integrity" regulations. On June 30, 2012, the U.S. District Court for the District of Columbia struck down the metrics for gainful employment programs and certain related requirements, including the requirement that an institution obtain Department of Education approval for new gainful employment programs; the court ruled one day before the metrics would have gone into effect. The program integrity regulations are described above in "Regulation of Title IV Financial Aid Programs - Recent Regulatory Changes."

On May 5, 2011, the Department of Education announced its intention to establish additional negotiated rulemaking committees to prepare proposed regulations under the Higher Education Act. Three public hearings were conducted in May 2011 at which interested parties suggested issues that should be considered for action by the negotiating committees. The Department of Education also conducted roundtable discussions to inform policy in the areas of teacher preparation, college completion, and the proposed "First in the World" competition. In spring 2012, the Department of Education convened two negotiated rulemaking committees- one on teacher preparation and one on student loans- that each held a series of meetings to discuss proposed changes to applicable regulations. Negotiators reached consensus on proposed regulatory language on 25 student loan issues, which will result in two packages of proposed rules to be published for public comment before final promulgation. Proposed rules relating to various loan repayment issues, including a new income-based repayment plan for the Direct Loan program, were issued November 1, 2012. Although the rule was originally scheduled to become effective on July 1, 2013, the Department of Education announced the rule would go into effect on December 21, 2012. Also, the Department of Education issued a NPRM on July 17, 2012 addressing discharges of loans for borrowers who suffer from total and permanent disability, and the Department of Education promulgated final rules on November 1, 2012. Proposed rules relating to other loan-related topics are expected in 2013, to be effective in 2014.

Negotiators failed to reach consensus on proposed regulations related to teacher preparation programs and the awarding of TEACH Grants. The committee disagreed about how, if at all, students' test scores should be used to judge the effectiveness of their teachers preparation program. Such so-called “value added scores” were promoted by the Department of Education during the negotiations as one way to determine which institutions should be eligible to award TEACH Grants to students in their teacher preparation programs. As the negotiators failed to reach consensus, the Department of Education is now responsible for drafting proposed regulations, to be released at a future date.

If our efforts to comply with new and pending regulations are inconsistent with how the Department of Education interprets those provisions, due to uncertainty about the meaning of the rules or otherwise, we may be found to be in noncompliance with such provisions and the Department of Education could impose monetary penalties, place limitations on our operations, and/or condition or terminate our eligibility to receive Title IV program funds. We cannot predict with certainty the effect the new and pending regulatory provisions will have on our business.

A number of the risk factors below address potential substantive concerns and risks with respect to the new regulations. With respect to the final regulations generally, and each of the regulations discussed in the risk factors below specifically, we cannot predict how the final regulations will be interpreted. Compliance with any of these new rules or uncertainty that results from the rules being recently promulgated and the absence of past practice and limited guidance as to the implementation of these new rules could have an adverse impact on our enrollment, affect the manner in which we do business, increase our cost of doing business, and have a material adverse effect on our business, financial condition, results of operations and cash flows. Lack of clarity in the final rules or guidance by the Department of Education could result in uncertainties continuing for some period of time, and may require us to adopt overly-narrow practices until clarity is obtained, and as a result our business could be materially and adversely affected.

A failure to meet U.S. Department of Education standards regarding “gainful employment” may result in the loss of eligibility to participate in Title IV programs.

On June 13, 2011, the Department of Education published final regulations on gainful employment programs effective July 1, 2012. The regulations established metrics related to student loan repayment rates and debt-to-income ratios for gainful employment programs. If a program failed all three of the gainful employment metrics in a given year, the U.S. Department of Education would require the institution to disclose the amount by which the program under-performed the metrics and the institution’s plan for program improvement. Also, the regulations required an institution to establish a three-day waiting period for enrollment after the warning information is given. If a program failed to achieve the metrics twice within three years, the institution had to continue to provide the first year disclosures and, among other things, also disclose to current and prospective students that they should expect to have difficulty repaying their student loans; provide an explanation of the risks associated with enrolling or continuing in the program, including the potential consequences for, and options available to, the student if the program became ineligible for Title IV funds; and explain the resources available to research other educational options and compare program costs. Should a program fail three times within a four year period, the regulations permitted the Department of Education to terminate the program’s eligibility for federal student aid (i.e., students in the program would immediately lose eligibility to participate in Title IV programs), and the institution would not be able to reestablish the program’s eligibility for at least three years, though the program could continue to operate without Title IV funding. In addition, the regulations required institutions to notify the Department of Education at least 90 days before commencing a new educational program leading to gainful employment in a recognized occupation. The regulations required the Department of Education to approve a new program in certain circumstances.

On June 30, 2012, the U.S. District Court for the District of Columbia vacated these regulations. The court did not vacate the requirement that institutions provide information to prospective students on their website and in their promotional materials about their gainful employment programs, such as the occupations that the gainful employment program prepares the student to enter, on-time graduate rates for students in the program, cost, job placement rate, and median loan debt incurred by graduates of the program. The Department of Education required institutions to make such disclosures by July 1, 2011, and to update such disclosures for the 2011-2012 award year by January 31, 2013. These disclosure requirements, and the requirements for reporting to the Department and to our students information relating to programs, have increased our administrative burdens. The disclosure requirements could impact student enrollment and retention in ways that we cannot now predict. For example, if our disclosures compare unfavorably with those of other educational institutions, such disclosures could adversely impact student enrollment.

On July 30, 2012, the Department of Education filed a motion to alter or amend the court's June 30, 2012 judgment. The Department of Education argued in its motion that even though it would not be permitted to sanction education institutions for failure to meet the debt measure thresholds (i) education institutions should disclose information to the Department of Education that will allow the Department of Education to calculate the debt measures and (ii) education institutions should include the results of the debt measure calculations in their disclosures to prospective students. On September 24, 2012, the U.S. District Court for the District of Columbia requested a supplemental briefing by the parties addressing, in brief, (i) the scope of the Department of Education's statutory authorization to maintain a database of information about student borrowers and (ii) the authority on which the Department of Education relied to argue that it could require education institutions to provide information to the Department of Education for purposes of calculating the debt measures and then require education institutions to disclose the results of those debt measure calculations. The parties filed supplemental briefs in November 2012, and the U.S. District Court for the District of Columbia is expected to render a decision in 2013. If the regulations are reinstated on appeal or repromulgated by the Department of Education, it is not possible at this time to determine with any degree of certainty whether such future regulations will cause any of our programs to become ineligible to participate in the Title IV programs owing to factors beyond our control, such as changes in the actual or deemed income level of our graduates, changes in student borrowing levels, increases in interest rates, changes in the federal poverty income level relevant for calculating discretionary income, changes in the percentage of our former students who are current in repayment of their student loans, and other factors. In addition, even though deficiencies in the metrics may be correctible on a timely basis, if we are required to disclose such metrics to students it may adversely impact enrollment in certain programs and may adversely impact the reputation of our educational institutions.

Our failure to obtain Department of Education approval, where required, for new programs that prepare students for gainful employment in a recognized occupation could materially and adversely affect our business.

On October 29, 2010, the Department of Education issued final regulations to establish a new process under which an institution applies for approval to offer an educational program that prepares students for gainful employment in a recognized occupation. Under the final regulations, which became effective July 1, 2011, an institution must notify the Department of Education at least 90 days before the first day of class when it intends to add a program that prepares students for gainful employment in a recognized occupation. The institution seeking approval may proceed to offer the program, unless the Department of Education advises the institution at least 30 days before the first day of classes that the Department of Education must approve the program for Title IV purposes. If the Department of Education denies approval, the institution may not award Title IV funds in connection with the program. On June 30, 2012, U.S. District Court for the District of Columbia vacated the regulations requiring the U.S. Department of Education to receive notice of (and possibly approve) any new program that prepares students for gainful employment, which for APUS includes most of its programs. Pending a final ruling in this case, the Department of Education has advised institutions to follow the rules on additional programs that immediately preceded the gainful employment rules. The version once again in effect provides that approval of new programs is not required if the additional program prepares students for gainful employment in the same or related occupation as an educational program that has previously been designated as eligible and is at least eight semester hour, 12 quarter hours, or 600 clock hours. It is unclear whether the Department of Education will repromulgate the regulation in a form that can withstand challenge. See “Risks Related to the Regulation of our Industry” for additional information on these new program approval requirements. If the Department were to deny approval to one or more of our new programs, our business could be materially and adversely affected. Furthermore, compliance with any new procedures could cause delay in our ability to offer new programs and put our business at a competitive disadvantage. Compliance could also adversely affect our ability to timely offer programs of interest to our students and potential students and adversely affect our ability to increase our revenues. As a result, our business could be materially and adversely affected.

Our failure to comply with the Department of Education’s incentive payment rule could result in sanctions.

If we pay a bonus, commission, or other incentive payment in violation of applicable Department of Education rules, we could be subject to sanctions, which could have a material adverse effect on our business. In the final regulations published on October 29, 2010, the Department of Education abolished 12 safe harbors that described permissible arrangements under the regulation. The amended regulation was effective July 1, 2011. Abolition of the safe harbors and other aspects of the new regulation may create uncertainty about what constitutes impermissible incentive payments. The modified incentive payment rule and related uncertainty as to how it will be interpreted also may influence our approach, or limit our alternatives, with respect to employment policies and practices and consequently may affect negatively our ability to recruit and retain employees, and as a result our business could be materially and adversely affected.

In addition, the Government Accountability Office, or GAO, has issued a report critical of the Department of Education's enforcement of the incentive payment rule, and the Department of Education has undertaken to increase its enforcement efforts. If the Department of Education determines that an institution violated the incentive payment rule, it may require the institution to modify its payment arrangements to the Department of Education's satisfaction. The Department of Education may also fine the institution or initiate action to limit, suspend, or terminate the institution's participation in the Title IV programs. The Department of Education may also seek to recover Title IV funds disbursed in connection with the prohibited incentive payments. In addition, third parties may file "qui tam" or "whistleblower" suits on behalf of the Department of Education alleging violation of the incentive payment provision. Such suits may prompt Department of Education investigations. Particularly in light of the uncertainty surrounding the new incentive payment rule, the existence of, the costs of responding to, and the outcome of, qui tam or whistleblower suits or Department of Education investigations could have a material adverse effect on our reputation causing our enrollments to decline and could cause us to incur costs that are material to our business, among other things. As a result, our business could be materially and adversely affected

Our failure to comply with the Department of Education's substantial misrepresentation rules could result in sanctions.

The Department of Education may take action against an institution in the event of substantial misrepresentation by the institution concerning the nature of its educational programs, its financial charges or the employability of its graduates. In the final regulations published on October 29, 2010, the Department of Education has expanded the activities that constitute a substantial misrepresentation, effective July 1, 2011. Under the final regulation, an institution engages in substantial misrepresentation when the institution itself, one of its representatives, or an organization or person with which the institution has an agreement to provide educational programs, marketing, advertising, or admissions services, makes a substantial misrepresentation directly or indirectly to a student, prospective student or any member of the public, or to an accrediting agency, a state agency, or to the Secretary of Education. The final regulations define misrepresentation as any false, erroneous or misleading statement, and they define a misleading statement as any statement that has the likelihood or tendency to deceive or confuse. The final regulations define substantial misrepresentation as any misrepresentation on which the person to whom it was made could reasonably be expected to rely, or has reasonably relied, to the person's detriment. If the Department of Education determines that an institution has engaged in substantial misrepresentation, the Department of Education may revoke an institution's program participation agreement, impose limitations on an institution's participation in the Title IV programs, deny participation applications made on behalf of the institution, or initiate a proceeding against the institution to fine the institution or to limit, suspend or termination the institution's participation in the Title IV programs. On June 5, 2012, the U.S. Court of Appeals for the District of Columbia vacated portions of the substantial misrepresentation regulation that permitted the U.S. Department of Education to: (i) revoke an institution's program participation agreement or impose limitations on an institution's participation without affording procedural protections; (ii) proscribe misrepresentations with respect to subjects not covered by the Higher Education Act; and (iii) proscribe statements that are merely confusing. The court remanded the matters so that the Department of Education can revise the regulations. The Department of Education could promulgate regulations that expand its role in monitoring and enforcing prohibitions on misrepresentation. This could lead to an increase in administrative actions and litigation claiming substantial misrepresentation, which at a minimum would increase legal costs associated with defending such actions. As a result, our business could be materially and adversely affected.

Failure to comply with the Department of Education's credit hour requirements could result in sanctions.

In the final regulations published on October 29, 2010, the Department of Education has defined "credit" hour for Title IV purposes. The credit hour is used for Title IV purposes to define an eligible program and an academic year and to determine enrollment status and the amount of Title IV aid that an institution may disburse in a payment period. The final regulations define credit hour as an institutionally established equivalency that reasonably approximates certain specified time in class and out of class or an equivalent amount of work for other academic activities. The final regulations also require institutional accreditors to review an institution's policies, procedures, and administration of policies and procedures for assignment of credit hours. An accreditor must take appropriate actions to address an institution's credit hour deficiencies and to notify the Department of Education if it finds systemic noncompliance or significant noncompliance in one or more programs. The Department of Education has indicated that if it finds an institution to be out of compliance with the credit hour definition for Title IV purposes, it may require the institution to repay the amount of Title IV awarded under the incorrect assignment of credit hours and, if it finds significant overstatement of credit hours, it may fine the institution or limit, suspend, or terminate its participation in Title IV programs, as a result of which our business could be materially and adversely affected.

Failure to comply with the Department of Education's state authorization rules could result in our students being ineligible for Title IV programs.

To be eligible for Title IV programs, an institution must be legally authorized to provide postsecondary education in the state in which it is physically located. In the final regulations published on October 29, 2010, the Department of

Education specified the type of state approvals that are acceptable for an institution to demonstrate that it is legally authorized by the state in which it is located. The regulations also provide that states must have mechanisms to take appropriate action against institutions and to respond to complaints.

Currently, APUS is headquartered in the State of West Virginia and is authorized by the West Virginia Higher Education Policy Commission. APUS has a physical presence in the Commonwealth of Virginia based on administrative offices in that state, and it is authorized by the State Council of Higher Education for Virginia. We believe that the only state licensure or authorization that is currently necessary for APUS to participate in the tuition assistance programs for the United States Armed Forces and in Title IV programs is our authorization from the West Virginia Higher Education Policy Commission. It is possible that West Virginia and other states could, as a result of the limited amount of time for states to evaluate and implement the Department of Education’s final state authorization rule or otherwise, adopt standards that are detrimental to institutions such as ours. As a result, our business could be materially and adversely affected. If we acquire additional locations, we will need to seek authorization from the states where they are physically located.

If APUS does not maintain its authorization in West Virginia, our operations would be curtailed, and we may not grant degrees.

APUS is headquartered in the State of West Virginia and is authorized by the West Virginia Higher Education Policy Commission to grants degrees, diplomas and certificates. The West Virginia Higher Education Policy Commission may also take disciplinary action or revoke authorization if an institution's bond is cancelled, if the institution fails to take corrective action to bring it into compliance with West Virginia Higher Education Policy Commission policies, or if the owner is convicted for a felony or crime involving institution administration of Title IV programs.

Under current West Virginia law, if we were to lose our accreditation by The Higher Learning Commission, the West Virginia Higher Education Policy Commission may suspend, withdraw, or revoke our authorization. In addition, in order to maintain our eligibility for accreditation by The Higher Learning Commission, we must remain headquartered and have a substantial presence in one of the states in its region, which includes West Virginia. Thus, if we were to lose our authorization from the West Virginia Higher Education Policy Commission, we would be unable to provide educational services in West Virginia, we would lose our eligibility for Title IV programs, and we would lose our regional accreditation.

Our failure to comply with regulations of various states could have a material adverse effect on our enrollments, revenues, and results of operations.

Various states impose regulatory requirements on educational institutions operating within their boundaries. Several states assert jurisdiction over online educational institutions that have no physical location or other presence in the state but offer educational services to students who reside in the state or advertise to or recruit prospective students in the state. State regulatory requirements for online education are inconsistent among states and not well developed in many jurisdictions. As such, these requirements change frequently and, in some instances, are not clear or are left to the discretion of state regulators.

In final regulations published on October 29, 2010, the Department of Education stated that if an institution offers postsecondary education through distance education to students in a state in which the institution is not physically located, the institution must meet state requirements for it to be legally offering postsecondary distance education in that state. That rule was effective on July 1, 2011, although in an April 2011 guidance letter the Department of Education indicated that it would not initiate any action to establish repayment liabilities or limit student eligibility for distance education activities undertaken before July 1, 2014, provided the institution was making a good faith effort to identify and obtain necessary state authorization before that date. On July 12, 2011, the U.S. District Court for the District of Columbia vacated the portion of the Department of Education's state authorization regulation that requires online education providers to obtain any required authorizations from all states in which their students reside, finding that the Department of Education had failed to provide sufficient notice and opportunity for comment on the requirement.

On June 5, 2012, the U.S. Court of Appeals for the District of Columbia affirmed the district court's July 12, 2011 ruling. On July 27, 2012, the Department of Education issued a Dear Colleague Letter cautioning education institutions to remain in compliance with all applicable state laws and regulations related to distance education. The level of regulatory oversight varies substantially from state to state. In some U.S. states, institutions are subject to licensure by the state education agency and also by a separate state agency or agencies, depending on the programs offered. Some states have sought to assert jurisdiction over online educational institutions that offer educational services to residents in the state or that advertise or recruit in the state, notwithstanding the lack of a physical location in the state. State laws may establish standards for instruction, qualifications of faculty, location and nature of facilities, financial policies and responsibility and other operational matters. State laws and regulations may limit our ability to obtain authorization to operate in certain states or to award degrees or diplomas or offer new degree programs. Furthermore, certain states prescribe standards of financial responsibility that are different from those prescribed by the U.S. Department of Education.

The Department of Education's distance-education state authorization requirement could lead some states to adopt new laws and regulatory practices affecting the delivery of distance education to students located in those states. In the event we are found not to be in compliance with a state's new or existing requirements for offering distance education within that state, the state could seek to restrict one or more of our business activities within its boundaries, we may not be able to recruit students from that state, and may have to cease providing service to students in that state. In addition, the Department of Education has not announced its next steps, but it may engage in the future in a negotiated rulemaking to address distance education and state authorization. Should the federal distance education requirements published in October 2010 be enforced in the future, and if we fail to obtain required state authorization to provide postsecondary distance education in a specific state, we could lose our ability to award Title IV aid to students in that state.

The requirements of some states' regulations could make it more difficult for us to successfully pursue particular program initiatives.

Some states have regulations that apply to certain types of programs. For example, a number of states require that we obtain additional authorizations for our students to pursue sponsored internships or participate in practicums in the states, even where we have no other physical presence in the state. These types of provisions may make it more difficult for us to offer certain programs or degrees in those states. Program initiatives, such as our teacher education programs, that include "on the ground" components (e.g., student teaching, professional internships, etc.) that may be described as instructional activities, will be viewed by some state regulatory agencies as constituting a physical presence for regulatory purposes. As we expand some of our existing programs and pursue new programs, there is a high probability that we will need to seek formal authorization to operate in some states where historically we were not required to do so. The extent of this expansion in regulatory requirements, and the associated costs, are not known at this time, but we anticipate they may be significant. Furthermore, there may be some states where it takes a significant amount of time to meet the applicable regulatory requirements with respect to a new program initiative, or where we are not able to do so at all. The inability to efficiently or successfully expand existing programs and pursue new program initiatives would harm our ability to grow our business and meet our business objectives and could lead to higher regulatory costs and expose us to adverse actions by state regulators.

Our experience with the Title IV programs is limited, because we only began to participate in the programs in 2006, and our failure to comply with the complex regulations associated with Title IV programs would have a significant adverse effect on our operations and prospects for growth.

We first became certified to participate in Title IV programs for classes beginning in November 2006. We expect a significant portion of our growth in enrollments and revenues to come from students who are utilizing funds from Title IV programs. However, compliance with the requirements of the Higher Education Act and Title IV programs is highly complex and imposes significant additional regulatory requirements on our operations, which require additional staff, contractual arrangements, systems and regulatory costs. We have limited demonstrated history of compliance with these additional regulatory requirements, and as discussed in the risk factor immediately below, in 2012 the Department of Education found that we failed to properly calculate and return federal financial aid in accordance with applicable Title IV policies, resulting in APUS having a $1,040,851 liability to the Department. If we fail to comply with any of the regulatory requirements under Title IV programs, the Department of Education could, among other things, impose monetary penalties, place limitations on our operations, and/or condition or terminate our eligibility to receive Title IV program funds, which would limit our potential for growth outside the military sector and adversely affect our enrollment, revenues, and results of operations.

Government and regulatory agencies and third parties may conduct compliance reviews, bring claims, or initiate litigation against us, any of which could disrupt our operations and adversely affect our performance.

Because we operate in a highly regulated industry, we are subject to compliance reviews and claims of noncompliance and lawsuits by government agencies, regulatory agencies, and third parties, including claims brought by third parties on behalf of the federal government. For example, the Department of Education regularly conducts program reviews of educational institutions that are participating in the Title IV programs and the Office of Inspector General of the Department of Education regularly conducts audits and investigations of such institutions. In August 2010, the Secretary of Education announced in a letter to several members of Congress that, in part in response to recent allegations against proprietary institutions of deceptive trade practices and noncompliance with Department of Education regulations, the Department planned to strengthen its oversight of Title IV programs through, among other approaches, increasing the number of program reviews by 50%, from 200 conducted in 2010 up to 300 reviews in 2011. If the results of compliance reviews or other proceedings are unfavorable to us, or if we are unable to defend successfully against lawsuits or claims, we may be required to pay monetary damages or be subject to fines, limitations, loss of Title IV funding, injunctions, or other penalties, including the requirement to make refunds. Even if we adequately address issues raised by an agency review or successfully defend a lawsuit or claim, we may have to divert significant financial and management resources from our ongoing business operations to address issues raised by those reviews or to defend against those lawsuits or claims. Claims and lawsuits brought against us may damage our reputation, even if such claims and lawsuits are without merit.

On February 28, 2011 the U.S. Department of Education began an on-site program review of APUS' administration of the Title IV programs. On May 14, 2012 the Department of Education issued a Final Program Review Determination, or FPRD. The FPRD (1) identified liabilities resulting from the program review report findings, (2) provided instructions for payment of the liabilities to the Department of Education, (3) notified APUS of its right to appeal, and (4) notified APUS that under Department of Education regulations, APUS is required to post an irrevocable letter of credit payable to the U.S. Secretary of Education due to the number of unpaid and late refunds identified as part of the program review. The liabilities and letter of credit requirements are based on the program review report's finding that APUS' policies improperly failed to treat certain students as having unofficially withdrawn from the institution and that APUS consequently failed to calculate and return federal student financial aid to the Department of Education as a result of these unofficial withdrawals. The FPRD stated that APUS' total monetary liability, including interest, is $1,040,851. Notwithstanding that the Company disagrees with the Department's position, after considering the time, effort, expense and other factors involved in a full appeal, the Company determined to pay the liability. Because we cannot be assured that we will be able to collect the full amounts from the relevant former students, we have established a partial reserve against these receivables. We will continue to monitor the collection history and the reserve established. In response to the FPRD, we have also posted an irrevocable letter of credit in favor of the Department of Education in the amount of $163,284.

Certain of our students are eligible to receive funds from education assistance programs administered by the Department of Veterans Affairs, including under the GI Bills. Pursuant to federal law related to those programs, we are approved for education of veterans and members of the selective reserve and their dependents by the state approving agencies in Virginia and West Virginia. On April 16, 2012, the Department of Veterans Affairs began an on-site program review of our programs. The on-site review was concluded on April 20, 2012, and we have not yet received a formal report from the Department of Veterans Affairs.

We must periodically seek recertification to participate in Title IV programs, and may, in certain circumstances, be subject to review by the Department of Education prior to seeking recertification, and our future success may be adversely affected if we are unable to successfully maintain certification or obtain recertification.

An institution generally must seek recertification from the Department of Education at least every six years and possibly more frequently depending on various factors, such as whether it is provisionally certified. The Department of Education may also review an institution's continued eligibility and certification to participate in Title IV programs, or scope of eligibility and certification, in the event the institution undergoes a change in ownership resulting in a change of control or expands its activities in certain ways, such as the addition of certain types of new programs, or, in certain cases, changes to the academic credentials that it offers. In certain circumstances, the Department of Education must provisionally certify an institution, such as when it is an initial participant in Title IV programs or has undergone a change in ownership and control. In 2006, we applied to participate in Title IV programs for the first time and were provisionally certified for a period through June 30, 2007. We timely submitted our application for recertification, and the Department of Education granted us provisional certification through June 30, 2008. In May 2008, we were fully recertified to participate in Title IV programs. In August 2008, we were deemed to have undergone a change in ownership and control requiring review by the Department of Education in order to reestablish our eligibility and continue participation in Title IV programs. As required under Department of Education regulations, we timely notified the Department of Education of our change in ownership and control. In connection with the Department of Education's review of the change, we submitted to the Department of Education a change in ownership application that included the submission of required documentation, including a letter from The Higher Learning Commission indicating that it had approved the change. On October 2, 2008, we received a letter from the Department of Education approving the change in ownership and control and granting us provisional certification until September 30, 2010.

A provisionally certified institution must apply for and receive Department of Education approval of substantial changes and must comply with any additional conditions included in its program participation agreement. If the Department of Education determines that a provisionally certified institution is unable to meet its responsibilities under its program participation agreement, it may seek to revoke the institution's certification to participate in Title IV programs with fewer due process protections for the institution than if it were fully certified. The Department of Education may withdraw the institution's certification if it determines that the institution is not fulfilling material requirements for continued participation in Title IV programs.

In 2010, we applied for recertification and, on July 2, 2010, we received a letter from the Department of Education notifying us that we are fully recertified to participate in Title IV programs through December 31, 2014. If the Department of Education were to withdraw or not renew our certification to participate in Title IV programs, our students would no longer be able to receive Title IV program funds, which would have a material adverse effect on our enrollments, revenues, and results of operations. In addition, regulatory restraints related to the addition of new programs could impair our ability to attract and retain students and could negatively affect our financial results.

The U.S. Congress has been examining the for-profit postsecondary education sector, which could result in legislation or additional Department of Education rulemaking that may limit or condition Title IV program participation of proprietary schools in a manner that may materially and adversely affect our business.

In recent years, the U.S. Congress has increased its focus on for-profit education institutions, including a review of their participation in the Title IV programs. Beginning in June 2010, the HELP Committee held hearings to examine the proprietary education sector. On August 5, 2010, we received a letter from Senator Tom Harkin, Chairman of the HELP Committee, requesting documents as part of a review of matters related to for-profit postsecondary education institutions whose students receive federal student financial aid. We understand that the request was one of approximately thirty requests made to for-profit colleges in connection with the HELP Committee's review of matters related to for-profit colleges participating in Title IV programs. In June 2010, the Education and Labor Committee of the U.S. House of Representatives held a hearing to examine accreditors' standards and procedures pertinent to higher education institutions' policies on credit hours and program length. During the hearing, some committee members voiced concerns about the growing proportion of federal student financial aid going to proprietary institutions. On June 21, the chairmen of each of the Senate and House education committees, together with other members of Congress, requested the GAO to conduct a review and prepare a report with recommendations regarding various aspects of the proprietary education sector, including recruitment practices, educational quality, student outcomes, the sufficiency of integrity safeguards against waste, fraud and abuse in Title IV programs, and the degree to which proprietary institutions' revenue is comprised of Title IV and other federal funding sources. On August 4, the GAO released a report based on a three-month undercover investigation of recruiting practices at proprietary institutions, which concluded that employees at a non-random sample of 15 proprietary institutions (which did not include APUS) made deceptive statements to students about accreditation, graduation rates, job placement, program costs, or financial aid. On November 30, 2010, the GAO issued a revised version of that report that corrected or further explained a number of the instances of allegedly deceptive conduct. We incurred significant legal and other costs to respond to the congressional inquiry, and could incur significant legal and other cost to respond to any future inquiries.

On August 4, 2010, the Senate HELP Committee held a hearing to examine the student recruitment experience at for-profit postsecondary education institutions, and on September 30, 2010, the Senate HELP Committee held a hearing in regard to the federal investment in for-profit education and the resulting student outcomes. The Senate HELP Committee held additional hearings in 2011. On March 10, 2011, the Committee held a hearing to present a case study of another for-profit postsecondary education institution, its educational services, and the role of accreditor, state, and federal oversight. A hearing about financial outcomes of students at for-profit colleges was held by the Senate HELP Committee on June 7, 2011. At a number of hearings, committee members have expressed concern about the amount of student loan debt taken on by students at for-profit institutions. Following those hearings, on July 21, 2011, the Committee hosted a roundtable discussion of policy solutions for improving for-profit postsecondary education. On July 30, 2012, the HELP Committee issued a final report entitled "For Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success," which summarized the results of its investigations. While the report acknowledged that for-profit education institutions have a role to play in American society given insufficient capacity at not-for-profit and public education institutions, it made specific policy suggestions for future legislation that could affect proprietary institutions, including:

- tying access to federal aid to meeting minimum student outcome thresholds;
- prohibiting institutions from funding marketing, advertising and recruiting activities with federal financial aid dollars;
- improving cohort default rate tracking by expanding the default reporting rate period beyond 3 years;
- requiring that proprietary colleges receive at least 15 percent of revenues from sources other than federal funds; and
- using criteria beyond accreditation and state authorization for determining institutions' access to federal financial aid.

The report was not adopted by the full Committee, and the minority Members released their own report criticizing the majority's investigation in many aspects, including that it did not include a review of all institutions of higher education. Despite the fact that the full committee did not adopt the report, Congress may consider the report as it begins the process of reauthorizing the Higher Education Act.

On September 21, 2012, a group of senators wrote a letter to the Federal Trade Commission urging it to evaluate the marketing practices utilized by many proprietary institutions through the use of third-party lead generators. In addition, legislation was introduced in the Senate in April 2012, which would prevent institutions from using Title IV funds for marketing activities.

On October 31, 2011, the GAO released a second report following additional undercover investigation related to enrollment, cost, financial aid, course structure, substandard student performance, withdrawal, and exit counseling. The report concluded that while some of the 15 unidentified for-profit schools investigated appeared to follow existing policies, others did not. Although the report identified a number of deficiencies in specific instances, it made no recommendations. On December 7, 2011, the GAO released a report that attempted to compare the quality of education provided by for-profit, not-for-profit, and public schools based upon multiple outcome measures including graduation rates, pass rates on licensing exams, employment outcomes, and student loan default rates. The report found that for-profit school students had higher graduation rates for certificate programs, similar graduation rates for associate's degree programs, and lower graduation rates for bachelor's degree programs than students at not-for-profit and public schools. It also found that a higher proportion of bachelor's degree recipients from for-profit schools took out loans than did degree recipients from other schools and that there is some evidence that students at for-profits schools default on their student loans at higher rates. On nine of the 10 licensing exams reviewed, graduates of for-profit schools had lower pass rates than students from not-for-profit and public schools.

The Consumer Financial Protection Bureau, or CFPB, submitted two reports to Congress in 2012 with specific recommendations for restructuring the student borrowing experience, including requiring institutions to certify that a student is not eligible for any further federal funds before a private loan may be issued to such student. In addition, on January 31, 2013, CFPB encouraged institutions of higher education, students, and others to provide information to the CFPB by March 18, 2013 about the financial products and services currently offered to students, and comments on how current and future arrangements between institutions of higher education and financial institutions could be structured in order to promote positive financial decision-making among consumers. On January 23, 2013, Senator Durbin introduced the Know Before You Owe Private Student Loan Act of 2013, which would require institutions to certify to a private loan lender a student's cost of attendance and estimated federal financial assistance before a loan may be issued to such student. The Act would also require institutions to counsel students about their loan options, including discussion of differences between federal loans and private loans. Private loan lenders would be required to provide students with quarterly account updates on the balance and interest accrued. On January 23, 2013, Senator Durbin also introduced the Fairness for Struggling Students Act of 2013, which would allow private student loans to be dischargeable in bankruptcy. We do not know what steps Congress may take in response to these actions and whether such actions (if any) will have an adverse effect on our business or results of operations.

In addition, other Congressional hearings and reviews addressing various aspects of the education sector may occur, which may affect our business. The confluence of the increasing scrutiny in Congress of the proprietary education sector and the unprecedented federal budget deficits increases the likelihood of legislation that will adversely impact our business. We cannot predict the extent to which, or whether, these hearings and reviews will result in legislation, further rulemaking affecting our participation in Title IV programs, or more vigorous enforcement of Title IV requirements. Legislation, for example, could be focused on measures of student outcomes that do not take into account that as an institution that has historically had an open enrollment policy, we will naturally have a lower graduation rate than institutions that have selective admission policies. To the extent that any laws or regulations are adopted that limit or condition Title IV program participation or the amount of federal student financial aid for which our students are eligible, our business could be materially and adversely affected.

Congressional examination of Department of Defense oversight of tuition assistance used for distance education and proprietary institutions and pending rulemaking by the Department of Defense could result in legislative or regulatory changes that may materially and adversely affect our business.

In recent years, the U.S. Congress has increased its focus on DoD tuition assistance that is used for distance education and programs at proprietary institutions. In September 2010, the Subcommittee on Oversight and Investigations of the U.S. House of Representative’s Armed Services Committee held a hearing titled “A Question of Quality and Value: Department of Defense Oversight of Tuition Assistance Used for Distance Learning and For-Profit Colleges.” Witnesses and Subcommittee members expressed concern about DoD’s oversight of distance education programs, especially those offered by proprietary institutions. In August 2010, DoD issued a proposed regulation that would increase oversight of educational programs offered to active duty service members. The final rule, published December 7, 2012 and effective January 7, 2013, requires all institutions to sign a Memorandum of Understanding, or MOU, by March 1, 2013. The MOU outlines certain commitments and agreements between the institution and DoD prior to accepting funds under the tuition assistance program. We have entered into a standard MOU with DoD.

In addition, in December 2010, the Senate HELP Committee released a report entitled “Benefitting Whom? For-Profit Education Companies and the Growth of Military Educational Benefits,” which raised questions about the growing share of DoD tuition assistance received by proprietary institutions. In March 2011, the GAO published a report entitled “DoD Education Benefits: Increased Oversight of Tuition Assistance Program is Needed,” which offered several recommendations for improving accountability within the tuition assistance program. In September 2011, the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security held a hearing focused on the classification of military education benefits under the “90/10 Rule,” which requires proprietary institutions to derive at least 10 percent of their revenue from non-Title IV sources. Some of the panelists suggested that the classification of military benefits as non-Title IV revenue for purposes of the 90/10 Rule has led some for-profit institutions to recruit aggressively and sometimes illegally members of the military in order to ensure compliance with the 90/10 Rule. Senator Harkin, Chairman of the Senate Committee on Health, Education, Labor & Pensions spoke on the Senate floor on May 19, 2011 and hosted a press conference on September 22, 2011 encouraging reformation of the 90/10 Rule. Senator Harkin has accused for-profit institutions of engaging in deceptive marketing and aggressive recruiting in order to enroll veteran and active duty military members. He has also criticized for-profit institutions on the basis of their program withdrawal rates and demanded more accountability for the use of federal funds. In addition, the President's EO, issued April 27, 2012, establishing Principles to strengthen oversight, in part, of the DoD tuition assistance program requires federal agencies to implement the Principles through various actions. Congress may also decide to take action in response to the Principles.

We cannot predict the extent to which, or whether, congressional hearings result in legislation or further rulemaking affecting our participation in DoD's tuition assistance program or the Title IV programs. Members of Congress have stated, both in committee hearings and in the HELP Committee report, that Congress should revise the 90/10 Rule to count DoD tuition assistance and veterans educational benefits toward the 90% limit. In January 2012, Senators Harkin and Durbin introduced a bill to modify the 90/10 Rule by reducing the threshold to 85% and counting the Title IV programs, the DoD tuition assistance program, and veterans education benefits programs as sources from which an institution may derive no more than 85% of its revenue. In February 2012, companion bills were introduced in the U.S. Senate and U.S. House of Representatives that would modify the 90/10 Rule to count DoD tuition assistance and veterans education benefits toward the 90% limit, along with Title IV programs. On May 29, 2012, attorneys general for 21 states called on Congress to enact this type of legislation. We cannot predict the likelihood that Congress will amend the 90/10 Rule to count DoD tuition assistance and veterans education benefits toward the 90% limit or to lower the ratio to 85/15, nor can we predict the likelihood that Congress or President Obama will not take some other action to limit tuition assistance and veterans education benefits to proprietary institutions. To the extent that any laws or regulations are adopted that limit or condition the participation of proprietary schools or distance education programs in DoD tuition assistance programs or in Title IV programs with respect to DoD tuition assistance programs, or that limit or condition the amount of tuition assistance for which proprietary schools or distance education programs are eligible, our business could be materially and adversely affected.

Our regulatory environment and our reputation may be negatively influenced by the actions of other for-profit institutions.

We are one of a number of for-profit institutions serving the postsecondary education market. In recent years, regulatory investigations and civil litigation have been commenced against several companies that own for-profit educational institutions. These investigations and lawsuits have alleged, among other things, deceptive trade practices and noncompliance with Department of Education regulations. These allegations have attracted adverse media coverage and have been the subject of federal and state legislative hearings. Broader allegations against the overall for-profit school sector may negatively affect public perceptions of for-profit educational institutions, including APUS. In addition, in recent years reports on student lending practices of various lending institutions and schools, including for-profit schools, and investigations by a number of state attorneys general, Congress and governmental agencies have led to adverse media coverage of postsecondary education. Adverse media coverage regarding other companies in the for-profit school sector or regarding us directly could damage our reputation, could result in lower enrollments, revenues and operating profit, and could have a negative impact on our stock price. Such allegations could also result in increased scrutiny and regulation by the Department of Education, Congress, accrediting bodies, state legislatures, or other governmental authorities with respect to all for-profit institutions, including us.

Sequestration could reduce demand by reducing the availability of Title IV funds and increasing processing time and could have similar effects on tuition assistance funds.

Congressional actions that reduce Title IV program funding (whether through across-the-board funding reductions, sequestration or otherwise) or materially affect the eligibility of APUS or its students to participate in Title IV programs would have a material adverse effect on our enrollment, financial condition, results of operations and cash flows. On December 23, 2011, President Obama signed into law the Consolidated Appropriations Act of 2012, which made several alterations to federal student aid programs authorized under Title IV. Also, under the Budget Control Act of 2011, Congress must develop legislation to achieve further deficit reduction, and the outcome of this process is uncertain. The Budget Control Act of 2011 and the Statutory Pay-As-You-Go Act of 2010 each provide for the possibility of automatic across-the-board reductions in federal spending (also known as “sequestration”) as a budgetary enforcement tool. On January 2, 2013, President Obama signed legislation to avoid the so-called “fiscal cliff.” However, unless Congress takes further action, sequestration will begin on March 1, 2013. The House Committee on the Budget released a report in January 2013 stating that programs administered by the Department of Veterans Affairs will be exempt from sequestration. If sequestration is triggered by either the Budget Control Act of 2011 or the Statutory Pay-As-You-Go Act of 2010, funding for Title IV programs would be affected. Pell Grants would be exempt from cuts through fiscal year 2013, but could be subject to sequestration in fiscal year2014 and beyond. Most other federal student aid programs would be subject to across-the-board cuts to discretionary programs at a rate of approximately 8.2%. Origination fees for Stafford loans and PLUS loans would increase approximately 7.6%, to approximately 1.076% and 4.034% of the total loan, respectively. Cuts to the Department of Education's Federal Student Aid Administration budget could lead to delays in student eligibility determinations and delays in processing and origination of federal student loans. A reduction in the maximum annual Pell Grant amount or changes in eligibility could increase student borrowing and make it more difficult for us to comply with other regulatory requirements, such as the cohort default rate regulations. In addition, the Department of Education's Federal Student Aid administration budget would be reduced by sequestration, which could delay student eligibility determinations and processing of federal student loans. Furthermore, in the event of sequestration, the amounts available under the tuitions assistance programs of the Department of Defense could also be significantly curtailed or even eliminated, and the time for the various services to process requests for tuition assistance could be lengthened. These events could make it more difficult for students to obtain funding for an APUS education, either in a timely manner or at all, and would have an adverse effect on our results of operations.

Congress may change the law or reduce funding for Title IV programs, which could reduce our student population, revenues and profit margin.

On April 18, 2012, Senators Kay Hagan and Tom Harkin introduced new legislation that would prohibit colleges and universities from using funds from Title IV programs, military tuition assistance, veterans education benefits programs, and other federal educational assistance funds to pay for marketing, advertising, and recruiting. If a similar bill were introduced in the 113th Congress and enacted, it would significantly affect our ability to identify and attract prospective students.

The Higher Education Act comes up for reauthorization by Congress approximately every five to six years. When Congress does not act on complete reauthorization, there are typically amendments and extensions of authorization. On August 2, 2011, President Obama signed The Budget Control Act of 2011, which eliminated Direct Subsidized Loans for graduate and professional students, as of July 1, 2012. The cost of borrowing will increase for graduate students who defer payment of interest while enrolled, which could adversely impact our enrollments. In addition, there is no assurance that Congress will not in the future enact changes that decrease Title IV program funds available to students, including students who attend our institution. Any action by Congress that significantly reduces funding for Title IV programs or the ability of our school or students to participate in these programs would require us to arrange for other sources of financial aid and would materially decrease our enrollment. Such a decrease in enrollment would have a material adverse effect on our revenues and results of operations. Congressional action may also require us to modify our practices in ways that could result in increased administrative and regulatory costs and decreased profit margin. We are not in a position to predict with certainty whether any legislation will be passed by Congress or signed into law in the future. The reallocation of funding among Title IV programs, material changes in the requirements for participation in such programs, or the substitution of materially different Title IV programs could reduce the ability of certain students to finance their education at our institution and adversely affect our revenues and results of operations.

Investigations by state attorneys general, Congress, and governmental agencies regarding relationships between loan providers and educational institutions and their financial aid officers may result in increased regulatory burdens and costs.

In recent years, the student lending practices of postsecondary educational institutions, financial aid officers, and student loan providers have been subjected to several investigations by state attorneys general, Congress, and governmental agencies. These investigations concern, among other things, possible deceptive practices in the marketing of private student loans and loans provided by lenders pursuant to Title IV programs. The Higher Education Opportunity Act, or HEOA, contains new requirements pertinent to relationships between lenders and institutions. In particular, HEOA requires institutions to have a code of conduct, with certain specified provisions, pertinent to interactions with lenders of student loans, prohibits certain activities by lenders and guaranty agencies with respect to institutions, and establishes substantive and disclosure requirements for lists of recommended or suggested lenders of federal and private student loans. In addition, HEOA imposes substantive and disclosure obligations on institutions that make available a list of recommended lenders for potential borrowers.

On August 29, 2012, the Consumer Financial Protection Bureau submitted a report to the Senate Committee on Banking, Housing, and Urban Affairs, the Senate HELP Committee, the House of Representatives Committee on Financial Services, and the House of Representatives Committee on Education and the Workforce entitled "Private Student Loans." The report contained specific suggestions for Congressional action to restructure the student lending experience, including possibly requiring institutions to certify that a student is not eligible for any further federal funds before a private loan may be issued to such student. On October 16, 2012, the Consumer Financial Protection Bureau's Ombudsman for private student loan matters issued a report containing recommendations for the Senate Committee on Banking, Housing, and Urban Affairs, the Senate HELP Committee, the House Committee on Financial Services, the House Committee on Education and the Workforce, the Secretary of the Treasury, the Director of the Consumer Financial Protection Bureau, and the Secretary of Education. The report addressed potential reforms to student loan servicing and expansion of loan modification and refinancing options. In addition, on October 18, 2012, the Consumer Financial Protection Bureau released a report entitled "The Next Front? Student Loan Servicing and the Cost to Our Men and Women in Uniform." The report details the challenges that some service members have encountered when utilizing private and federal student loans. In January 2013, CFPB encouraged institutions of higher education, students, and others to provide information by March 18, 2013 about the financial products and services currently offered to students, and comments on how current and future arrangements between institutions of higher education and financial institutions could be structured in order to promote positive financial decision-making among consumers. We do not know what steps Congress or federal agencies may take in response to these reports and whether such actions (if any) will have an adverse effect on our business or results of operations.

In addition, state legislators have also passed or may be considering legislation related to relationships between lenders and institutions. We can neither know nor predict with certainty the effects of such developments. Governmental action may impose increased administrative and regulatory costs and decreased profit margins.

We are subject to sanctions that could be material to our results and damage our reputation if we fail to calculate correctly and return timely Title IV program funds for students who withdraw before completing their educational program.

A school participating in Title IV programs must calculate correctly the amount of unearned Title IV program funds that have been disbursed to students who withdraw from their educational programs before completion and must return those unearned funds in a timely manner, generally within 45 days after the date the school determines that the student has withdrawn. Because we began to participate in Title IV programs in 2006 and the final regulations published on October 29, 2010 include new rules applicable to return of Title IV calculations, we have limited experience complying with these provisions. Furthermore, as discussed above, in 2012 the Department of Education found, in a conclusion with which the Company disagrees, that we failed to do so properly with respect to $1,040,851 of Title IV funds. Under Department of Education regulations, late returns of Title IV program funds for 5% or more of students sampled in connection with the institution's annual compliance audit constitutes material noncompliance. If unearned funds are not properly calculated and timely returned, we may have to repay Title IV funds, post a letter of credit in favor of the Department of Education or otherwise be sanctioned by the Department of Education, which could increase our cost of regulatory compliance and adversely affect our results of operations.

A failure to demonstrate “financial responsibility” may result in the loss of eligibility by APUS to participate in Title IV programs or require the posting of a letter of credit in order to maintain eligibility to participate in Title IV programs.

To participate in Title IV programs, an eligible institution must satisfy specific measures of financial responsibility prescribed by the Department of Education, or post a letter of credit in favor of the Department of Education and possibly accept other conditions, such as provisional certification, additional reporting requirements, or regulatory oversight, on its participation in Title IV programs. The Department of Education may also apply such measures of financial responsibility to the operating company and ownership entities of an eligible institution and, if such measures are not satisfied by the operating company or ownership entities, require the institution to post a letter of credit in favor of the Department of Education and possibly accept other conditions on its participation in Title IV programs. Any obligation to post a letter of credit could increase our costs of regulatory compliance. If we were unable to secure a letter of credit, we would lose our eligibility to participate in Title IV programs. In addition to the obligation to post a letter of credit under certain circumstances, an institution that is determined by the Department of Education not to be financially responsible may be transferred from the “advance” system of payment of Title IV funds, which allows the institution to obtain Title IV program funds from the Department of Education prior to making disbursements to students, to cash monitoring status or to the “reimbursement” system of payment, which requires the institution to make Title IV disbursements to students and seek reimbursement from the Department of Education. A change in our system of payment could increase our costs of regulatory compliance. If we fail to demonstrate financial responsibility and thus lose our eligibility to participate in Title IV programs, our students would lose access to Title IV program funds for use in our institution, which would limit our potential for growth outside the military community and adversely affect our enrollment, revenues and results of operations.

A failure to demonstrate “administrative capability” may result in the loss of APUS' eligibility to participate in Title IV programs.

Department of Education regulations specify extensive criteria an institution must satisfy to establish that it has the requisite “administrative capability” to participate in Title IV programs. See “Regulation of our Business” in this annual report for more information on the Department of Education’s regulations on administrative capability.

If an institution fails to satisfy any of these criteria or comply with any other Department of Education regulations, the Department of Education may require the repayment of Title IV funds, transfer the institution from the “advance” system of payment of Title IV funds to cash monitoring status or to the “reimbursement” system of payment, place the institution on provisional certification status, or commence a proceeding to impose a fine or to limit, suspend or terminate the participation of the institution in Title IV programs. If we are found not to have satisfied the Department of Education’s “administrative capability” requirements, we could be limited in our access to, or lose, Title IV program funding, which would limit our potential for growth outside the military sector and adversely affect our enrollment, revenues, and results of operations.

We have limited experience internally administering our participation in Title IV programs and failure to comply with applicable regulations could cause us to lose our eligibility to participate in Title IV programs.

We recently determined to terminate our relationship with Global Financial Aid Services, Inc., or Global, which had assisted us with administration of our participation in Title IV programs since we began to participate in those programs in 2006, and to administer our participation in Title IV programs internally. To effect this transition, we will require cooperation and on-going assistance from Global during a period of transition. To the extent Global declines to cooperate with us, or responds to our requests for assistance in a less than timely fashion, we may not be able to effect this transition in a timely and cost-efficient manner. Furthermore, we may not realize the expected efficiencies from this transition, and given our lack of experience administering Title IV programs on our own, we may not be able to effectively do so. If our ability to comply with the requirements of Title IV programs is effected because of disputes or delays in connection with the transition process or because of problems administering Title IV programs on our own, we could be subject to the sanctions discussed in the risk factors above and it could limit our enrollments, revenues, and results of operation.

We may lose eligibility to participate in Title IV programs if our student loan default rates are too high, and if we lose that eligibility our future growth could be impaired.

An educational institution may lose its eligibility to participate in some or all Title IV programs if, for three consecutive federal fiscal years, 25% or more of its students who were required to begin repaying their student loans in the relevant federal fiscal year default on their payment by the end of the next federal fiscal year. In addition, an institution may lose its eligibility to participate in some or all Title IV programs if its default rate exceeds 40% in the most recent federal fiscal year for which default rates have been calculated by the Department of Education. HEOA modifies the Higher Education Act’s default rate provisions. Because we began only recently to enroll students who are participating in the federal student loan programs, we have no historical cohort default rate for federal fiscal year 2007 or earlier. Our cohort default rate for federal fiscal years 2008, 2009, and 2010 are 5.2%, 4.0% and 6.0%, respectively.

Beginning with default rate calculations for federal fiscal year 2009, the cohort default rate will be calculated by determining the rate at which borrowers who become subject to their repayment obligation in the relevant federal fiscal year default by the end of the second following federal fiscal year. (the "three-year cohort default rate"). In September 2012, the Department of Education began publishing the official three-year cohort default rates. The Department of Education will publish the three-year cohort default rates in addition to the current method of calculating rates (described in the paragraph above) until the phase-in of the three-year measurement period is complete. As of September 2014, only the three-year cohort default rates will be applied for purposes of measuring compliance, beginning with the three-year cohort default rate for the 2011 cohort. An institution will lose its eligibility to participate in certain Title IV programs 30 days after it receives notice from the Department of Education that its most recent cohort default rate for fiscal year 2011 or later is greater than 40%. In addition, an institution may lose its eligibility to participate in certain Title IV programs 30 days after it receives notice from the Department of Education that its three most recent cohort default rates are each 30% or greater. Our official three-year cohort default rate for 2009 is 7.2%.

If our student loan default rates approach the limits detailed above, we may be required to increase our efforts and resources dedicated to improving these default rates. In addition, because there is a lag between the funding of a student loan and a default thereunder, many of the borrowers who are in default or at risk of default are former students with whom we may have only limited contact. Accordingly, there can be no assurance that we would be able to effectively improve our default rates or improve them in a timely manner to meet the requirements for continued participation in Title IV funding if we experience a substantial increase in our student loan default rates. If APUS loses its eligibility to participate in Title IV programs because of high student loan default rates, our students would no longer be eligible to use Title IV program funds in our institution, which would significantly reduce our enrollments and revenues and have a material adverse effect on our results of operations.

If we undergo a change in ownership and control, the Department of Education will place us on provisional certification, and the terms of that provisional certification could limit our potential for growth outside the military sector and adversely affect our enrollment, revenues, and results of operations.

Department of Education regulations provide that a change of control of a publicly traded corporation occurs if: (1) there is an event that would obligate the corporation to file a Current Report on Form 8-K with the SEC disclosing a change of control or (ii) the corporation has a stockholder that owns at least 25% of the total outstanding voting stock of the corporation and is the largest stockholder of the corporation, and that stockholder ceases to own at least 25% of such stock or ceases to be the largest stockholder. A significant purchase or disposition of our voting stock could be determined by the Department of Education to be a change in ownership and control under this standard. Under the Higher Education Act, an institution that undergoes a change in ownership resulting in a change in control loses its eligibility to participate in Title IV programs and must apply to the Department of Education in order to reestablish such eligibility.

During our period of provisional certification, we had to comply with any additional conditions included in our program participation agreement, which included, among other things, limitations on our operations. Our program participation agreement provided that, as a provisionally certified institution, we had to apply for and receive approval by the Secretary for any substantial change, including but not limited to establishment of additional locations, an increase in the level of academic offering, and addition of any non-degree or short-term training program. The Department of Education also had authority to review us more closely during our provisional certification. On July 2, 2010, we received a letter from the Department of Education notifying us that we are fully recertified to participate in Title IV programs through December 31, 2014.

Future transactions could constitute a change in ownership or control under Department of Education regulations and could cause the Department to place us on provisional certification as require by the law when an institution undergoes a change in ownership and control. The conditions to provisional certification or closer review by the Department of Education could impact, among other things, our ability to add educational programs, acquire other schools, or make other significant changes. In addition, if the Department of Education were to determine that we were unable to meet our responsibilities while we were provisionally certified, the Department could seek to revoke our certification to participate in Title IV programs with fewer due process protections than if we were fully certified. Limitations on our operations could, and the loss of our certification to participate in Title IV programs would, adversely affect our ability to grow our presence outside the military sector in addition to having adverse effects on our enrollment, revenues, and results of operations.

If regulators do not approve or delay their approval of transactions involving a change of control of our company, our ability to operate could be impaired.

If we or APUS experience a change of control under the standards of applicable state education agencies, the Department of Education,The Higher Learning Commission, or other regulators, we must notify or seek the approval of each relevant regulatory agency. Transactions or events that constitute a change of control include significant acquisitions or dispositions of an institution’s common stock and significant changes in the composition of an institution’s board of directors. Some of these transactions or events may be beyond our control. Our failure to obtain, or a delay in receiving, approval of any change of control from the West Virginia Higher Education Policy Commission, the State Council of Higher Education for Virginia, the Department of Education or The Higher Learning Commission could have a material adverse effect on our business and financial condition. Our failure to obtain, or a delay in receiving, approval of any change of control from other states in which we are currently licensed or authorized could require us to suspend our activities in that state or otherwise impair our operations. The potential adverse effects of a change of control could influence future decisions by us and our stockholders regarding the sale, purchase, transfer, issuance, or redemption of our stock. In addition, the regulatory burdens and risks associated with a change of control also could have an adverse effect on the market price of your shares.

Our business could be harmed if we experience a disruption in our ability to receive federal funding.

We collected the substantial majority of our fiscal year 2012 total consolidated net revenue from federal government funding sources, such as Title IV financial aid program funds, including from federal student loans under the Federal Direct Loan Program, DoD tuition benefits and veterans education benefits. Any processing disruptions by the U.S. Department of Education, DoD or the Department of Veterans Affairs may impact our students' ability to obtain student loans or tuition benefits, respectively, on a timely basis. If we experience a disruption in our ability to process student loans through the Direct Loan Program or to process tuition benefits for military students through DoD because of administrative challenges on our part or the inability of the Department of Education, DoD or Department of Veterans Affairs to process the volume of direct loans, military tuition benefits or veterans benefits, respectively, on a timely basis, our business, financial condition, results of operations and cash flows could be adversely and materially affected.

Risks Related to Owning our Common Stock

The price of our common stock may be volatile, and as a result returns on an investment in our common stock may be volatile.

We completed our initial public offering in November 2007. For a significant portion of the time since our initial public offering, we have had relatively limited public float, and trading in our common stock has also been limited and, at times, volatile. An active trading market for our common stock may not be sustained, and the trading price of our common stock may fluctuate substantially.

The price of the common stock may fluctuate as a result of:

price and volume fluctuations in the overall stock market from time to time;

significant volatility in the market price and trading volume of comparable companies;

actual or anticipated changes in our earnings, enrollments or net course registrations, or fluctuations in our operating results or in the expectations of securities analysts;

the actual, anticipated or perceived impact of changes in government policies, laws and regulations, or similar changes made by accrediting bodies;

the depth and liquidity of the market for our common stock;

general economic conditions and trends;

catastrophic events;

sales of large blocks of our stock; or

recruitment or departure of key personnel.

In the past, following periods of volatility in the market price of a company’s securities, securities class action litigation has often been brought against that company. Because of the potential volatility of our stock price, we may become the target of securities litigation in the future. Securities litigation could result in substantial costs and divert management’s attention and resources from our business.

Seasonal and other fluctuations in our results of operations could adversely affect the trading price of our common stock.

Our results in any quarter may not indicate the results we may achieve in any subsequent quarter or for the full year. Our revenues and operating results normally fluctuate as a result of seasonal or other variations in our enrollments. Student population varies as a result of new enrollments, graduations, student attrition, the success of our marketing programs and other reasons that we cannot always anticipate. While our number of enrolled students has grown in each sequential quarter over the past three years, the number of enrolled students has been proportionally greatest in the fourth quarter of each respective year. A significant portion of our general and administrative expenses do not vary proportionately with fluctuations in revenues. We expect quarterly fluctuations in operating results to continue as a result of seasonal enrollment patterns. Such patterns may change, however, as a result of new program introductions and increased enrollments of students, or as a result of other factors we cannot anticipate. These fluctuations may result in volatility in our results of operations and/or have an adverse effect on the market price of our common stock.

If securities analysts do not publish research or reports about our business or if they downgrade their evaluations of our stock, the price of our stock could decline.

The trading market for our common stock depends in part on the research and reports that industry or financial analysts publish about us or our business. If one or more of the analysts covering us downgrade their estimates or evaluations of our stock, the price of our stock could decline. If one or more of these analysts cease coverage of our company, we could lose visibility in the market for our stock, which in turn could cause our stock price to decline.

Provisions in our organizational documents and in the Delaware General Corporation Law may prevent takeover attempts that could be beneficial to our stockholders.

Provisions in our charter and bylaws and in the Delaware General Corporation Law may make it difficult and expensive for a third party to pursue a takeover attempt we oppose even if a change in control of our company would be beneficial to the interests of our stockholders. These provisions include:

- the ability of our board of directors to issue up to 10,000,000 shares of preferred stock in one or more series and to fix the powers, preferences and rights of each series without stockholder approval, which may discourage unsolicited acquisition proposals or make it more difficult for a third party to gain control of our company;

- a requirement that stockholders provide advance notice of their intention to nominate a director or to propose any other business at an annual meeting of stockholders;

- a prohibition against stockholder action by means of written consent unless otherwise approved by our board of directors in advance; and

- the application of Section 203 of the Delaware General Corporation Law, which generally prohibits us from engaging in mergers and other business combinations with stockholders that beneficially own 15% or more of our voting stock, or with their affiliates, unless our directors or stockholders approve the business combination in the prescribed manner.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We operate facilities in Charles Town, West Virginia and in Manassas, Virginia, which are within a one hour drive of each other and located within the Washington, DC metropolitan area. The corporate headquarters, academic, technology, finance, admissions, and admissions offices are located in Charles Town, occupying 14 downtown facilities totaling approximately 311,000 square feet. These properties include approximately 95,000 square feet that is currently unoccupied and either under construction or reserved for future expansion. The student services, graduations and marketing operations are located in Manassas in facilities totaling approximately 64,000 square feet. All facilities in Manassas are leased. In Charles Town, we have a combination of leased and owned properties, representing approximately 5% and 95% of total square footage, respectively. Lease terms vary by facility, with termination dates ranging from 2012 to 2015. Each lease has extension provisions ranging from one to seven years. There were five leased properties that terminated in 2012. Staff from these buildings moved into the new 105,000 square foot Finance Center. We have also acquired two and a half acres in Charles Town for future development to support the growth of our student service operations.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we have been and may be involved in various legal proceedings. We currently have no material legal proceedings pending.

ITEM 4. MINE SAFETY DISCLOSURES

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock began trading on the NASDAQ Global Market on November 9, 2007 under the symbol “APEI.” Prior to November 9, 2007, there was no public market for our common stock. The following table sets forth, for the period indicated, the high and low sales price of the Company’s common stock as reported on the NASDAQ Global Market.

Year Ended December 31, 2011	Low	High
First Quarter 2011	$33.43	$43.85
Second Quarter 2011	$40.00	$47.53
Third Quarter 2011	$33.38	$49.29
Fourth Quarter 2011	$27.20	$45.23
Year Ended December 31, 2012		
First Quarter 2012	$36.87	$46.96
Second Quarter 2012	$26.85	$39.90
Third Quarter 2012	$24.88	$39.16
Fourth Quarter 2012	$29.94	$38.81

Holders

As of February 25, 2013, there were approximately 471 holders of record of our common stock.

Dividends

We do not anticipate declaring or paying any cash dividends on our common stock in the foreseeable future. The payment of any dividends in the future will be at the discretion of our board of directors and will depend upon our financial condition, results of operations, earnings, capital requirements, contractual restrictions, outstanding indebtedness, and other factors deemed relevant by our board.

Performance Graph

The graph below compares American Public Education, Inc.’s cumulative 5-year total return of holders of American Public Education, Inc.'s common stock with the cumulative total returns of the S&P 500 index, the NASDAQ Composite index and a customized peer group of eleven companies that includes: Apollo Group Inc., Bridgepoint Education Inc., Capella Education Company, Career Education Corp., Corinthian Colleges Inc., DeVry Inc., Education Management Corp., Grand Canyon Inc., ITT Educational Services Inc., National American University Holdings Inc., and Strayer Education Inc.. The graph tracks the performance of a $100 investment in our common stock, in each index and in the peer groups (with the reinvestment of all dividends) from 12/31/2007 to 12/31/2012.

Recent Sales of Unregistered Securities

None.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

On May 14, 2012, the Company's Board of Directors authorized a program to repurchase up to $20 million of shares of the Company's common stock. Subject to market conditions, applicable legal requirements and other factors, the repurchases may be made in open market transactions or privately negotiated transactions. The authorization does not obligate the Company to acquire any shares, and purchases may be commenced or suspended at any time based on market conditions and other factors that the Company deems appropriate.

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)	Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (2)
October 1, 2012 to October 31, 2012	—	$—	—	—	$ 10,724,643
November 1, 2012 to November 30, 2012	83,855	$32.58	83,855	—	7,992,647
December 1, 2012 to December 31, 2012	—	$—	—	—	7,992,647
Total	83,855	$31.21	83,855	—	$ 7,992,647

(1) On December 9, 2011, the Company's Board of Directors approved a stock repurchase program for its common stock, under which the Company may annually purchase up to the cumulative number of shares issued or deemed issued under the Company's equity incentive and stock purchase plans. Repurchases may be made from time to time in the open market at prevailing market prices or in privately negotiated transactions from time to time based on business and market conditions. The stock repurchase program may be suspended or discontinued at any time, and will be funded using the Company's available cash. The Company had completed its repurchases for calendar year 2012 prior to the fourth quarter of 2012 and at that time there was no additional authority to purchase shares. However, this number will be increased in 2013 when additional shares are issued or deemed issued under the Company's equity incentive and stock purchase plans.

(2) On May 14, 2012, the Company's Board of Directors authorized a program to repurchase up to $20 million of shares of the Company's common stock. Subject to market conditions, applicable legal requirements and other factors, the repurchases may be made in open market transactions or privately negotiated transactions. The authorization does not obligate the Company to acquire any shares, and purchases may be commenced or suspended at any time based on market conditions and other factors that the Company deems appropriate.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our selected consolidated financial and operating data as of the dates and for the periods indicated. You should read this data together with "Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes, included elsewhere in this annual report on Form 10-K. The selected consolidated statement of operations data for each of the years in the three-year period ended December 31, 2012, and the selected consolidated balance sheet data as of December 31, 2012 and 2011, have been derived from our audited consolidated financial statements, which are included elsewhere in this annual report on Form 10-K. The selected consolidated statements of operations data for the years ended

December 31, 2008 and 2009, and selected consolidated balance sheet data as of December 31, 2010, 2009, and 2008, have been derived from our audited consolidated financial statements not included in this annual report on Form 10-K. Historical results are not necessarily indicative of the results of operations to be expected for future periods.

	Year Ended December 31,				
	2008	2009	2010	2011	2012
	(In thousands, except per share and net registration data)				
Statement of Operations Data:					
Revenues	$107,147	$148,998	$198,174	$260,377	$313,516
Costs and expenses:					
Instructional costs and services	43,561	58,383	75,309	95,216	110,192
Selling and promotional	12,361	20,479	34,296	44,713	59,761
General and administrative	21,302	25,039	32,045	48,350	63,615
Depreciation and amortization	4,235	5,231	6,502	9,239	11,146
Total costs and expenses	81,459	109,132	148,152	197,518	244,714
Income from continuing operations before interest income and income taxes	25,688	39,866	50,022	62,859	68,802
Interest income, net	706	94	111	109	135
Income from continuing operations before income taxes	26,394	39,960	50,133	62,968	68,937
Income tax expense	10,207	16,017	20,265	22,211	26,528
Investment income, net of taxes	—	—	—	—	(86)
Net income attributable to common stockholders	$16,187	$23,943	$29,868	$40,757	$42,323
Net income attributable to common stockholders per common share:					
Basic	$0.91	$1.32	$1.63	$2.28	$2.38
Diluted	$0.89	$1.27	$1.59	$2.23	$2.35
Weighted average number of shares outstanding:					
Basic	17,840	18,167	18,281	17,877	17,772
Diluted	18,222	18,906	18,837	18,295	18,041
Other Data:					
Net cash provided by operating activities	$29,757	$36,756	$47,078	$70,438	$52,838
Capital expenditures	$10,009	$10,758	$22,454	$24,925	$35,014
Stock-based compensation	$1,674	$2,223	$2,805	$3,189	$3,818
Adjusted net/Net course registrations(1)	140,758	198,392	259,389	341,669	402,205

	As of December 31,				
	2008	2009	2010	2011	2012
	(In thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$47,714	$74,866	$81,352	$119,006	$114,901
Working capital(2)	$36,357	$59,419	$60,417	$82,034	$86,004
Total assets	$78,813	$115,753	$141,839	$198,891	$237,603
Stockholders' equity	$53,475	$82,018	$97,300	$133,833	$171,153

	As of December 31,				
	2008	2009	2010	2011	2012
	(In thousands)				
Net income attributable to common stockholders	$16,187	$23,943	$29,868	$40,757	$42,323
Interest (income), net	(706)	(94)	(111)	(109)	(135)
Income tax expense	10,207	16,017	20,265	22,211	26,528

Investment loss, net of taxes	—	—	—	—	86
Depreciation and amortization	4,235	5,231	6,502	9,239	11,146
EBITDA from continuing operations	$29,923	$45,097	$56,524	$72,098	$79,948

(1)In 2012, net course registrations represent the total number of course registrations for students that have attended a portion of a course. For the years ended December 31, 2008, 2009, 2010 and 2011, one-credit lab courses were combined with their related three-credit courses.

(2)Working capital is calculated by subtracting total current liabilities from total current assets.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion together with the financial statements and the related notes included elsewhere in the annual report. This discussion contains forward-looking statements that are based on management’s current expectations, estimates and projections about our business and operations, and involves risks and uncertainties. Our actual results may differ materially from those currently anticipated and expressed in such forward-looking statements as a result of a number of factors, including those we discuss under “Risk Factors,” “Special Note Regarding Forward-Looking Statements,” and elsewhere in this annual report.

Overview

American Public Education, Inc. is a provider of online postsecondary education with an emphasis on the needs of the military and public service communities. We operate through two universities, American Military University, or AMU, and American Public University, or APU, which together constitute the American Public University System, or APUS.

We were founded as American Military University, Inc. in 1991 and began offering graduate courses in January 1993. Following accreditation by the Accrediting Commission of the Distance Education and Training Council, or DETC, a national accrediting agency, in 1995, American Military University began offering undergraduate programs primarily directed to members of the armed forces. Over time, American Military University diversified its educational offerings in response to demand by military students for post-military career preparation. With its expanded program offerings, American Military University extended its outreach to the greater public service community, primarily police, fire, emergency management personnel and national security professionals. In 2002, we reorganized into a holding company structure, with American Public Education, Inc. serving as the holding company of APUS, which operates our two universities, AMU and APU. Our university system achieved accreditation in May 2006 with The Higher Learning Commission of the North Central Association of Colleges and Schools, a regional accrediting agency, and became eligible for federal student aid programs under Title IV for classes beginning in November 2006.

Our course enrollments, or net course registrations, representing the aggregate number of classes in which students remain enrolled after the date by which they may drop the course without cost and combining one-credit lab courses with their related three-credit course for the years ended December 31, 2010 and 2011, increased at a compound annual growth rate (CAGR) of 25% from 2010 to 2012. Over that same time, total revenue increased at a CAGR of 26%, from \$198.2 million in 2010 to \$313.5 million in 2012. We believe achieving regional accreditation in May 2006, gaining access to Title IV programs beginning with classes that started in November 2006, and the variety and affordability of our programs have been some of the factors driving growth. Net course registrations increased by 18% in 2012 over 2011, our revenue increased from \$260.4 million to \$313.5 million, or by 20%, over the same time period, while operating margins decreased to 21.9% from 24.1% over the same time period. Net course registrations increased by 32% in 2011 over 2010, our revenue increased from \$198.2 million to \$260.4 million, or by 31%, over the same time period and operating margins decreased to 24.1% from 25.2% over the same time period. While we have experienced substantial growth in recent periods, you should not rely on the results of any prior periods as an indication of our future growth in adjusted net course registrations or revenue as we do not expect that our historical growth rates are sustainable. Similarly, you should not rely on our operating margins in any prior periods as an indication of our future operating margins.

Since gaining access to Title IV programs, a significant portion of our growth is attributable to students using Title IV programs. In addition to the positive impact this has had on our growth in net registrations and revenues, this has had other effects on our business and results of operations, including a change to the mix of students we serve. This has resulted, and will continue to result, in a need to provide a greater level of services to our students. Our costs and expenses as a percentage of revenue have increased due in part to increased general and administrative expenses related to this shift in student mix and primarily attributable to an increase in expenditures for financial aid processing fees, expenditures for technology required to support the increase in civilian students, and increased bad debt primarily associated with our civilian students. In order to support the number of students we now have and to plan for the future, we also expect that we will make significant investments in our technology infrastructure and financial aid processing capabilities, which from time to time, including in 2013, will result in an increased level of spending, not all of which can be capitalized.

The change to our student mix is also correlated to limitations we have encountered on our ability to make long range forecasts with respect to student enrollments. We have had more difficulty forecasting the number of students who will enroll, we have noticed a decrease in the predictability of the rate at which we convert leads into enrolled students, and we have had more difficulty attracting students that will perform well over the long term, all of which we attribute in part to the growth of civilian students, particularly the growth of civilian students from outside of public service communities.

In addition to the above factors related to Title IV programs and civilian students, in 2011 we observed that some students enroll or attempt to enroll solely to obtain Title IV funds, and some students who might not otherwise pursue a degree or certificate are attracted to enroll because of the availability of Title IV funds and economic hardships resulting from today’s economic climate. We believe these students may be more likely than other students to cease pursuing a degree or certificate due to other factors, such as becoming employed or not having the level of commitment necessary to complete successfully the required coursework. As a result, the growth in our enrollments in 2011 reflected some students who will not persist as students. We have also been the target of fraudulent activities by outside parties with respect to student enrollment and Title IV programs, and as we continue to grow we may be susceptible to an increased risk of such activities. We are not able to estimate the number of students who fall into these enrollment categories, and our ability to estimate the impact on our enrollments over time is limited, as is our ability to estimate any additional impact that this could have on our exposure to bad debt or the number of our students who default on their Title IV student loans.

Each of The Budget Control Act of 2011 and the Statutory Pay-As-You-Go Act of 2010 provide for the possibility of automatic across-the-board reductions in federal spending (also known as “sequestration”) as a budgetary enforcement tool. The House Committee on the Budget released a report in January 2013 stating that programs administered by the Department of Veterans Affairs will be exempt from sequestration. However, if sequestration is triggered, funding for Title IV programs would be affected. Pell Grants would be exempt from cuts through fiscal year 2013, but could be subject to sequestration in fiscal year 2014 and beyond. Most other federal student aid programs would be subject to across-the-board cuts to discretionary programs at a rate of approximately 8.2%. Origination fees for Stafford loans and PLUS loans would increase approximately 7.6%, to approximately 1.076% and 4.034% of the total loan, respectively. Cuts to the Department of Education's Federal Student Aid Administration budget could lead to delays in student eligibility determinations and delays in processing and origination of federal student loans. A reduction in the maximum annual Pell Grant amount or changes in eligibility could increase student borrowing and make it more difficult for us to comply with other regulatory requirements, such as the cohort default rate regulations. In addition, the Department of Education's Federal Student Aid administration budget would be reduced by sequestration, which could delay student eligibility determinations and processing of federal student loans. As a result of sequestration the amounts available under the tuition assistance programs of the Department of Defense could also be significantly curtailed or even eliminated, and the time for the various services to process requests for tuition assistance could be lengthened. These events could make it more difficult for students to obtain funding for an APUS education, either in a timely manner or at all, and would have an adverse effect on our results of operations.

Our key financial results metrics:

Revenues

In reviewing our revenues we consider the following components: net course registrations; tuition we charge; tuition net of scholarships; and other fees.

Net course registrations. For financial reporting and analysis purposes, we measure our student body in terms of aggregate course enrollments, or net course registrations. Net course registrations represent the aggregate number of classes in which students remain enrolled after the date by which they may drop the course without cost and combining one-credit lab courses with their related three-credit courses. Because we recognize revenues over the length of a course, net course registrations in a financial reporting period do not correlate directly with revenues for that period because revenues recognized from courses are not necessarily recognized in the financial reporting period in which the course registrations occur. For example, revenues in a quarter reflect a portion of the revenue from courses that began in a prior quarter and continued into the quarter, all revenue from courses that began and ended in the quarter, and a portion of the revenue from courses that began but did not end in the quarter.

We believe our curriculum is directly relevant to federal, state and local law enforcement and other first responders, but historically this market was limited to us because, outside the federal government, only a few agencies or departments have the tuition reimbursement plans critical to fund continuing adult education. In recent years, in part because our students can access Title IV programs, we have been increasing our focus on these markets. Title IV programs require participating students to take more courses per semester than students participating in Department of Defense, or DoD, tuition assistance programs. As a result, we expect that our increased focus on markets that utilize Title IV programs may cause the average number of courses per student per semester to increase.

Tuition. Providing affordable programs is an important element of our strategy for growth. Since 2000, we have not raised undergraduate tuition and have only increased graduate tuition by modest amounts in 2007, 2010 and 2011. We set our undergraduate tuition costs within the DoD ceilings. Using the DoD tuition ceiling as a benchmark keeps our tuition in line with four-year public university, in-state rates for undergraduates.

Net tuition. Tuition revenues vary from period to period based on the aggregate number of students attending classes and the number of classes they are attending during the period. Tuition revenue is adjusted to reflect amounts for students who withdraw from a course in the month the withdrawal occurs. We also provide scholarships to certain students to assist them financially and to promote their registration. The cost of these scholarships is netted against tuition revenue in the period incurred for purposes of establishing net tuition revenue and typically represents less than 1% of revenues.

Other fees. Other fees include charges for transcript credit evaluation, which includes assistance in securing official transcripts on behalf of the student in addition to evaluating transcripts for transfer credit. Students also are charged withdrawal, graduation, late registration, transcript request and comprehensive examination fees, when applicable. In accordance with Emerging Issues Tasks Force Issue No. 02-16, Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor (Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) Topic 605), other fees also includes book purchase commissions we receive for graduate student book purchases and ancillary supply purchases students make directly from our preferred book vendor. A technology fee of $50 per course was also implemented for course registrations beginning after September 1, 2012. The technology fee is earned over the length of the course. However, APUS provides a grant to cover the fee for active duty military, national guard and reserve personnel, and for anyone using DoD tuition assistance benefits. The grant also covers the fee for students using veterans education benefits.

Costs and Expenses

We categorize our costs and expenses as (i) instructional costs and services, (ii) selling and promotional, (iii) general and administrative, and (iv) depreciation and amortization.

Instructional costs and services. Instructional costs and services are expenses directly attributable to the educational services we provide our students. This expense category includes salaries and benefits for full-time faculty, administrators and academic advisors, and costs associated with adjunct faculty. Instructional pay for adjunct faculty is primarily dependent on the number of students taught. Instructional costs and services expenses also include costs for educational supplies such as books, costs associated with academic records and graduation, and other university services such as evaluating transcripts.

Substantially all undergraduate students receive their textbooks through our book grant program. Over the course of a complete bachelor’s degree program, this represents a potential average student savings of approximately $4,500 when compared to four-year public colleges according to The College Board Study, Annual Survey of Colleges report from 2009. In connection with our book grant program, we have been working to reduce the overall cost of books per course. Graduate students may order and pay for their books through the contracted vendor from which we purchase the undergraduate book grant program books or they can purchase books from a vendor of their choice.

Selling and promotional. Selling and promotional expenses include salaries and benefits of personnel engaged in recruitment and promotion, as well as costs associated with advertising and the production of marketing materials related to new enrollments and current students. Our selling and promotional expenses are generally affected by the cost of advertising media, the efficiency of our selling efforts, salaries and benefits for our selling and admissions personnel, and the number of advertising initiatives for new and existing academic programs. The availability of Title IV program funds to our students have increased our marketability in non-military markets, but the more competitive nature of these markets has caused our student acquisition costs to increase. As we continue to grow in size and continue to focus on students using Title IV funds outside of public service communities, this trend may continue and our student acquisition costs may continue to increase due to our marketing the APU brand and our efforts to realize a greater number of civilian student net registrations.

General and administrative. General and administrative expenses include salaries and benefits of employees engaged in corporate management, finance, information technology, human resources, facilities, compliance and other corporate functions. In addition, the cost of renting and maintaining our facilities, technology expenses, and costs for professional services are included in general and administrative costs. General and administrative expenses also include bad debt expense.

Depreciation and amortization. We incur depreciation and amortization expenses for costs related to the capitalization of property, equipment, software and program development on a straight-line basis over the estimated useful lives of the assets.

Interest Income, Net

Interest income, net consists primarily of interest income earned on cash and cash equivalents, net of any interest expense.

Critical Accounting Policies and Use of Estimates

The discussion of our financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP. During the preparation of these financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions, including those related to revenue recognition, accounts receivable and allowance for doubtful accounts, valuation of long-lived assets, contingencies, income taxes and stock-based compensation expense. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. The results of our analysis form the basis for making assumptions about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions, and the impact of such differences may be material to our consolidated financial statements.

A summary of our critical accounting policies follows:

Revenue recognition. We record all tuition as deferred revenue when students begin a class. At the beginning of each class, revenue is recognized on a pro rata basis over the period of the class, which is either eight or sixteen weeks. This results in our balance sheet including future revenues that have not yet been earned as deferred revenue for classes that are in progress. Students who request to be placed on program hold are required to complete or withdraw from the courses prior to being placed on hold. Other revenue includes charges for transcript credit evaluation, which includes assistance in securing official transcripts on behalf of the student in addition to evaluating transcripts for transfer credit. Students also are charged withdrawal, graduation, late registration, transcript request and comprehensive examination fees, when applicable. In accordance with FASB ASC Topic 605-50, Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor, other fees also includes book purchase commissions we receive for graduate student book purchases and ancillary supply purchases students make directly from our preferred book vendor. Tuition revenues vary from period to period based on the number of net course registrations. Students may remit tuition payments through the online registration process at any time or they may elect various payment options, including payments by sponsors, alternative loans, financial aid, or the DoD tuition assistance program that remits payments directly to us. These other payment options can delay the receipt of payment up until the class starts or longer, resulting in the recording of a receivable from the student and deferred revenue at the beginning of each session.

The Company refunds 100% of tuition for courses that are dropped by students before the conclusion of the first seven days of a course. Because courses begin the first Monday of every month and penalty free drops occur by the second Monday of every month, the Company does not recognize revenue for dropped courses. After a course begins and if a student does not drop their course, the following refund policy is used:

8-Week Course-- Tuition Refund Schedule

Withdrawal Request	Date Tuition Refund Percentage
Before or During Week 1	100%
During Week 2	75%
During Weeks 3 and 4	50%
During Weeks 5 through 8	No Refund

16-Week Course-- Tuition Refund Schedule

Withdrawal Request	Date Tuition Refund Percentage
Before or During Week 1	100%
During Week 2	100%
During Weeks 3 and 4	75%
During Weeks 5 through 8	50%
During Weeks 9 through 16	No Refund

Accounts receivable. Course registrations are recorded as deferred revenue and accounts receivable at the time students begin a course. Students may remit tuition payments through the online registration process at any time or they may elect various payment options, which can delay the receipt of payment up until the class starts or longer. These other payment options include payments by sponsors, alternative loans, financial aid, or a tuition assistance program that remits payments directly to us. When a student remits payment after a class has begun, accounts receivable is reduced. If payment is made prior to the start of class, the payment is recorded as a student deposit and the student is provided access to the classroom when classes start. If one of the various other payment options are confirmed as secured, the student is provided access to the classroom. If no receipt is confirmed or payment option secured, the student will be dropped from the class. Therefore, billed amounts represent invoices that have been prepared and sent to students or their sponsor, lender, financial aid, or tuition assistance program according to the billing terms agreed upon in advance. The DoD tuition assistance program is billed on a course-by-course basis when a student starts class, whereas federal financial aid programs are billed based on the classes included in a student's semester. Billed accounts receivable are considered past due if the invoice has been outstanding more than 30 days. The provision for doubtful accounts is based on management's evaluation of the status of existing accounts receivable. Recoveries of receivables previously written off are recorded when received. We do not charge interest on our past due accounts receivable.

Property and equipment. Property and equipment are carried at cost less accumulated depreciation. Depreciation and amortization are calculated on a straight-line basis over the estimated useful lives of the assets. Our Partnership At a Distance, or PAD, is a customized student information and services system, that manages admissions, online orientation, course registrations, tuition payments, grade reporting, progress toward degrees, and various other functions. Costs associated with the project have been capitalized in accordance with FASB ASC Topic 350, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, and classified as property and equipment. These costs are amortized over the estimated useful life of five years. The Company capitalizes the costs for program development. Costs are transferred to property and equipment upon completion of each program and amortized over an estimated life not to exceed three years.

Investment. On September 30, 2012, we made a $6.8 million or approximately 19.9% investment in preferred stock of NWHW Holdings, Inc., which in turn acquired New Horizons Worldwide, Inc., or New Horizons. New Horizons is a global IT training company operating over 300 locations around the world through franchise arrangements in 45 states and 70 countries. In connection with the investment, we are is entitled to certain rights, including right to representation on the board of directors of NWHW Holdings. We recorded the investment under the equity method and will recognize our share of earnings or losses in the investee in the periods for which they are reported with a corresponding adjustment in the carrying amount of the investment.

Note Receivable. In connection with the Company's minority investment in NWHW Holdings, Inc., the Company extended $6.0 million in credit to New Horizons in exchange for a subordinated note. The note matures on September 28, 2018 with monthly interest payments of 5.0% per annum during the first five years of the note and interest payments of 6.0% per annum in the sixth year. We evaluate the loan receivable by analyzing the borrower's creditworthiness, cash flows and financial status, and the condition and estimated value of the collateral. We consider a loan to be impaired when, based upon current information and events, we believe it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement.

Income taxes. Deferred taxes are determined using the liability method, whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. As those differences reverse, they will enter into the determination of future taxable income. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Stock-based compensation. Prior to 2012, we used a mix of stock options and restricted stock, but in 2012 we did not issue stock options. We apply FASB ASC Topic 718, Share-Based Payment, which requires the measurement and recognition of compensation expense for stock-based payment awards made to employees and directors, including employee stock options.

We have selected the Black-Scholes option pricing model to estimate the fair value of the stock option awards on the date of grant. Our determination of the fair value of these stock option awards was affected by the estimated fair value of our common stock on the date of grant, as well as assumptions regarding a number of highly complex and subjective variables. Prior to 2012, we calculated the expected term of stock option awards using the “simplified method” as defined by Security and Exchange Commission (SEC) Staff Accounting Bulletins No. 107 and 110 because we lacked historical data and were unable to make reasonable expectations regarding the future. We also estimate forfeitures of share-based awards at the time of grant and revise such estimates in subsequent periods if actual forfeitures differ from original projections. We make assumptions with respect to expected stock price volatility based on the average historical volatility of peers with similar attributes. In addition, we determine the risk free interest rate by selecting the U.S. Treasury five-year constant maturity, quoted on an investment basis in effect at the time of grant for that business day. Estimates of fair value are subjective and are not intended to predict actual future events, and subsequent events are not indicative of the reasonableness of the original estimates of fair value made under FASB Topic 718.

Recent Accounting Pronouncements

There have been no applicable announcements since our last filing.

Results of Operations

The following table sets forth statements of operations data as a percentage of revenues for each of the periods indicated:

	2010		2011		2012	
Revenues	100.0	%	100.0	%	100.0	%
Costs and expenses:						
Instructional costs and services	38.0	%	36.6	%	35.2	%
Selling and promotional	17.3	%	17.2	%	19.1	%
General and administrative	16.2	%	18.6	%	20.3	%
Depreciation and amortization	3.3	%	3.5	%	3.5	%
Total costs and expenses	74.8	%	75.9	%	78.1	%
Income from operations before interest income and income taxes	25.2	%	24.1	%	21.9	%
Interest income, net	0.1	%	—		0.1	%
Income from operations before income taxes	25.3	%	24.1	%	22.0	%
Income tax expense	10.2	%	8.5	%	8.5	%
Investment income, net of taxes	—		—		—	
Net income	15.1	%	15.6	%	13.5	%

Year Ended December 31, 2012 Compared to Year Ended December 31, 2011

Revenues

Revenues for the year ended December 31, 2012 were $313.5 million, an increase of 20% from $260.4 million for the year ended December 31, 2011. Net course registrations increased 18% to 402,205 in 2012 from 341,669 in 2011. The increase in net course registrations was primarily attributable to increased marketing efforts to civilian students interested in the affordability and diversity of our academic programs, and to some degree to an increase in students who enrolled solely to obtain Title IV funds and an increase in students who might not otherwise pursue a degree or certificate but are attracted to enroll because of the availability of Title IV funds.

Costs and Expenses

Costs and expenses were $244.7 million for the year ended December 31, 2012, an increase of $47.2million, or 24%, compared to $197.5 million for prior year ended December 31, 2011. This increase was due to the specific factors discussed below. Costs and expenses as a percentage of revenues increased to 78.1% in 2012 from 75.9% in 2011. Similarly, our income before interest income and income taxes, or our operating margin, decreased to 21.9% from 24.1% over that same period. This increase in costs and expenses as a percentage of revenues and decrease in operating margins resulted from the factors described below. Overall, our costs and expenses as a percentage of revenue increased due to increased general and administrative expenses primarily attributable to an increase in expenditures for financial aid processing fees, expenditures for technology required to support the increase in civilian students and regulatory changes, and increased bad debt primarily associated with our civilian students.

Instructional costs and services. Instructional costs and services expenses for the year ended December 31, 2012 were $110.2 million, representing an increase of 16% from $95.2 million for the year ended December 31, 2011. This increase was directly related to an increase in the number of classes offered due to the increase in net course registrations. Instructional costs and services expense as a percentage of revenues decreased to 35.2% in 2012 from 36.6% in 2011. This decrease was primarily due the number of full-time academic support staff increasing at a slower rate than revenue.

Selling and promotional. Selling and promotional expenses for the year ended December 31, 2012 were $59.8 million, representing an increase of 34% from $44.7 million for the year ended December 31, 2011. This increase was primarily due to an increase in internet advertising and introduction of radio and television advertising campaigns targeting our APU brand. Selling and promotional expenses as a percentage of revenues increased to 19.1% in 2012 from 17.2% in 2011 due to increased marketing of the APU brand.

General and administrative. General and administrative expenses for the year ended December 31, 2012 were $63.6 million, representing an increase of 31% from $48.4 million for the year ended December 31, 2011. The increase in expenditures was due to increased financial aid processing fees and expenditures for technology required to support the increase in civilian students, regulatory changes and bad debt expense. General and administrative expenses as a percentage of revenues increased to 20.3% in 2012 from 18.6% in 2011. This increase was primarily due to cost associated with our increased civilian population, regulatory changes, and bad debt expense increasing from $6.7 million in 2011 to $13.6 million in 2012, or from 2.6% of revenue in 2011 to 4.3% of revenue in 2012. This increase is due to civilian students that utilize federal financial aid and that do not complete their academic period, resulting in a return of federal student aid and a resulting unpaid balance due directly from the student, which in turn can result in bad debt.

Depreciation and amortization. Depreciation and amortization expenses were $11.1 million for the year ended December 31, 2012, compared with $9.2 million for the year ended December 31, 2011. This represents an increase of 21%. This increase resulted from greater capital expenditures and higher depreciation and amortization on a larger fixed asset base.

Stock-based compensation. Stock-based compensation included in instructional costs and services, selling and promotional and general and administrative expense for the year ended December 31, 2012 was $3.8 million in the aggregate, representing an increase of 20% from $3.2 million for the year ended December 31, 2011. The increase in stock-based compensation expense is primarily attributable to an increase in new restricted stock grants.

The table below reflects our stock-based compensation expense recognized in the consolidated statements of income for the years ended December 31, 2011 and 2012 (in thousands):

	Year Ended December 31,	
	2011	2012
Instructional costs and services	$ 893	$ 896
Selling and promotional	324	378
General and administrative	1,972	2,544
Total stock-based compensation expense	$ 3,189	$ 3,818

Income Tax Expense

We recognized tax expense from continuing operations for the year ended December 31, 2012 and 2011 of $26.5 million and $22.2 million, respectively, or effective tax rates of 38.5% and 35.3%, respectively. The effective tax rate in 2011 was impacted by state tax and research and development tax credit studies that were completed during the third quarter of 2011. The state tax study was undertaken to refine our allocation of income to various states. The research and development tax credit study was completed to claim the credit for our increased software development activities qualifying under the tax law. In addition, we claimed energy tax credits in connection with solar panel and charging stations for our facility in Charles Town.

Net Income

Net income was $42.3 million for the year ended December 31, 2012, compared to net income of $40.8 million for the year ended December 31, 2011, an increase of 4% or $1.5 million. This increase was related to the factors discussed above.

Year Ended December 31, 2011 Compared to Year Ended December 31, 2010

Revenues

Revenues for the year ended December 31, 2011 were $260.4 million, an increase of 31% from $198.2 million for the year ended December 31, 2010. Adjusted net course registrations increased 32% to 341,669 in 2011 from 259,389 in 2010. The increase in adjusted net course registrations was primarily attributable to increased marketing efforts to civilian students interested in the affordability and diversity of our academic programs, and to some degree to an increase in students who enrolled solely to obtain Title IV funds and an increase in students who might not otherwise pursue a degree or certificate but are attracted to enroll because of the availability of Title IV funds.

Costs and Expenses

Costs and expenses were \$197.5 million for the year ended December 31, 2011, an increase of \$49.3 million, or 33%, compared to \$148.2 million for prior year ended December 31, 2010. This increase was due to the specific factors discussed below. Costs and expenses as a percentage of revenues increased to 75.9% in 2011 from 74.8% in 2010. Similarly, our income before interest income and income taxes, or our operating margin, decreased to 24.1% from 25.2% over that same period. This increase in costs and expenses as a percentage of revenues and decrease in operating margins resulted from the factors described below. Overall, our costs and expenses as a percentage of revenue increased due to increased general and administrative expenses primarily attributable to an increase in expenditures for financial aid processing fees, expenditures for technology required to support the increase in civilian students and regulatory changes, and increased bad debt primarily associated with our civilian students.

Instructional costs and services. Instructional costs and services expenses for the year ended December 31, 2011 were $95.2 million, representing an increase of 26% from $75.3 million for the year ended December 31, 2010. This increase was directly related to an increase in the number of classes offered due to the increase in net course registrations. Instructional costs and services expense as a percentage of revenues decreased to 36.6% in 2011 from 38.0% in 2010. This decrease was primarily due the number of full-time academic support staff increasing at a slower rate than revenue.

Selling and promotional. Selling and promotional expenses for the year ended December 31, 2011 were $44.7 million, representing an increase of 30% from $34.3 million for the year ended December 31, 2010. This increase was primarily due to an increase in internet advertising and introduction of radio and television advertising campaigns targeting our APU brand. Selling and promotional expenses as a percentage of revenues decreased to 17.2% in 2011 from 17.3% in 2010 due to a favorable response to our marketing the APU brand resulting in a greater number of net registrations from civilian students.

General and administrative. General and administrative expenses for the year ended December 31, 2011 were $48.4 million, representing an increase of 51% from $32.1 million for the year ended December 31, 2010. The increase in expenditures was due to increased financial aid processing fees and expenditures for technology required to support the increase in civilian students, regulatory changes and bad debt expense. General and administrative expenses as a percentage of revenues increased to 18.6% in 2011 from 16.2% in 2010. This increase was primarily due to cost associated with our increased civilian population, regulatory changes, and bad debt expense increasing from $2.1 million in 2010 to $6.7 million in 2011, or from 1.1% of revenue in 2010 to 2.6% of revenue in 2011. This increase is due to civilian students that utilize federal financial aid and that do not complete their academic period, resulting in a return of federal student aid and a resulting unpaid balance due directly from the student, which in turn can result in bad debt.

Depreciation and amortization. Depreciation and amortization expenses were $9.2 million for the year ended December 31, 2011, compared with $6.5 million for the year ended December 21, 2010. This represents an increase of 42%. This increase resulted from greater capital expenditures and higher depreciation and amortization on a larger fixed asset base.

Stock-based compensation. Stock-based compensation included in instructional costs and services, selling and promotional and general and administrative expense for the year ended December 31, 2011 was $3.2 million in the aggregate, representing an increase of 14% from $2.8 million for the year ended December 21, 2010. The increase in stock-based compensation expense is primarily attributable to an increase in new stock options and restricted stock grants.

The table below reflects our stock-based compensation expense recognized in the consolidated statements of income for the years ended December 31, 2010 and 2011 (in thousands):

	Year Ended December 31,	
	2010	2011
Instructional costs and services	$717	$893
Selling and promotional	224	324
General and administrative	1,864	1,972
Total stock-based compensation expense	$2,805	$3,189

Income Tax Expense

We recognized tax expense from continuing operations for the year ended December 31, 2011 and 2010 of $22.2 million and $20.3 million, respectively, or effective tax rates of 35.3% and 40.4%, respectively. The reduction in the effective tax rate in 2011 is primarily due to the state tax and research and development tax credit studies that were completed during the third quarter of 2011. The state tax study was undertaken to refine our allocation of income to various states. The research and development tax credit study was completed to claim the credit for our increased software development activities qualifying under the tax law. In addition, we claimed energy tax credits in connection with solar panel and charging stations for the facility in Charles Town.

Net Income

Net income was $40.8 million for the year ended December 31, 2011, compared to net income of $29.9 million for the year ended December 31, 2010, an increase of 36% or $10.9 million. This increase was related to the factors discussed above.

Quarterly Results

The following table presents our unaudited quarterly results of operations for each of our eight last quarters ended December 31, 2012. You should read the following table in conjunction with the consolidated financial statements and related notes contained elsewhere in this annual report. We have prepared the unaudited information on the same basis as our audited consolidated financial statements. Results of operations for any quarter are not necessarily indicative of results for any future quarters or for a full year.

	Quarter Ended							
	March 31, 2011	June 30, 2011	September 30, 2011	December 31, 2011	March 31, 2012	June 30, 2012	September 30, 2012	December 31, 2012
	(Dollars in thousands) (Unaudited)							
Statement of Operations Data:								
Revenues	$58,664	$60,795	$ 65,251	$ 75,667	$75,822	$74,572	$ 77,122	$ 86,000
Costs and expenses:								
Instructional costs and services	22,105	23,011	23,948	26,152	27,853	26,249	26,436	29,654
Selling and promotional	10,884	9,721	11,705	12,403	14,371	14,475	14,430	16,485
General and administrative	10,511	10,910	12,160	14,769	16,072	16,141	15,978	15,424
Depreciation and amortization	2,093	2,242	2,404	2,500	2,656	2,715	2,760	3,015
Total costs and expenses	45,593	45,884	50,217	55,824	60,952	59,580	59,604	64,578
Income before taxes	13,071	14,911	15,034	19,843	14,870	14,992	17,518	21,422
Interest income, net	27	25	35	22	21	(34)	30	118
Income before income taxes	13,098	14,936	15,069	19,865	14,891	14,958	17,548	21,540
Income tax expense (benefit)	5,241	5,960	4,130	6,880	5,808	5,717	6,724	8,279
Investment, net of taxes	$—	$—	$ —	$ —	$—	$—	$ —	$ (86)
Net income	$7,857	$8,976	$ 10,939	$ 12,985	$9,083	$9,241	$ 10,824	$ 13,175
Other Data:								
Stock-based compensation	$862	$746	$ 812	$ 769	$1,014	$917	$ 940	$ 947
	$19,875	$5,799	$ 21,826	$ 22,938	$14,849	$7,849	$ 11,798	$ 18,342

Net cash provided by operating activities								
Capital expenditures	$3,597	$3,199	$ 6,978	$ 11,151	$6,577	$12,371	$ 9,562	$ 6,504
Net course registrations	81,094	77,857	87,331	95,387	100,992	92,890	103,047	105,276

Liquidity and Capital Resources

We financed our operating activities and capital expenditures during the years ended December 31, 2012 and 2011 primarily through cash provided by operating activities. Cash and cash equivalents were $114.9 million and $119.0 million at December 31, 2012 and 2011, respectively.

We derive a significant portion of our revenues from tuition assistance programs of the DoD. Generally, these funds are received within 60 days of the start of the classes to which they relate. A growing source of revenue is derived from our participation in Title IV programs, for which disbursements are governed by federal regulations, and we have typically received disbursements under this program within 30 days of the start of the applicable class.

These factors, together with the number of classes starting each month, affect our operational cash flow. Our costs and expenses have increased with the increase in student enrollment and the increase in the percentage of civilian students, and we expect to fund these expenses through cash from operations.

Based on our current level of operations and anticipated growth, we believe that our cash flow from operations and other sources of liquidity, including cash and cash equivalents, will provide adequate funds for ongoing operations and planned capital expenditures for the foreseeable future.

Operating Activities

Net cash provided by operating activities was $52.8 million, $70.4 million and $47.1 million for the years ended December 31, 2012, 2011, and 2010, respectively.

The decrease in cash flow from operations was due to an increase in accounts receivable, a difference in the timing of tuition payments received in advance from students, timing differences related to the payment of accounts payable and accrued expenses, and timing differences related to payment of book vendors.

Investing Activities

Net cash used in investing activities was $48.0 million, $25.2 million and $23.0 million for the years ended December 31, 2012, 2011, and 2010 respectively. Cash used in investing activities is primarily for capital expenditures, the majority of which have been related to buildings to support expansion, software development related to PAD, and computers and equipment to support increased staff as well as our investment in NWHW Holdings. We expect that we will continue to incur expenses for investing activities in strategic opportunities, or to enhance our business capabilities, such as our investment in NWHW Holdings. Furthermore, capital expenditures could be higher in the future as a result of the acquisition of existing structures or potential new construction projects that arise as a result of our ongoing evaluation of our space needs and opportunities for physical growth.

The Company will continue to explore opportunities to invest in other opportunities in the education industry, which could include purchasing other education related companies or investing in companies developing new technologies.

Financing Activities

Net cash used in financing activities was $8.9 million for the year ended December 31, 2012 compared with net cash used in financing activities of $7.6 million and $17.6 million for the year ended December 31, 2011 and 2010, respectively. The increase in cash used in financing activities was primarily related to an increase in share repurchases under our share repurchase program from $9.7 million in 2011 to $15.9 million in 2012.

Contractual Commitments

We have various contractual obligations consisting of operating leases. The following table sets forth our future contractual obligations as of December 31, 2012.

	Payments Due by Period			
	Total	Less than 1 Year	1-3 Years	3-5 Years
Operating lease obligations	2,238	1,081	1,157	—
Total contractual obligations	$2,238	$1,081	$1,157	$—

Off-Balance Sheet Arrangements

We do not have off-balance sheet financing arrangements, including any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities.

Impact of Inflation

We believe that inflation has not had a material impact on our results of operations for the years ended December 31, 2010, 2011 or 2012. There can be no assurance that future inflation will not have an adverse impact on our operating results and financial condition. We do not generally increase our undergraduate tuition rates; however, our costs do continually increase with inflation.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to the impact of interest rate changes and may be subject to changes in the market values of future investments. We invest our excess cash in bank overnight deposits. We have no material derivative financial instruments or derivative commodity instruments as of December 31, 2012.

Market Risk

We have no material derivative financial instruments or derivative commodity instruments. We maintain our cash and cash equivalents in bank deposit accounts, which at times may exceed federally insured limits. We have not experienced any losses in such accounts. We believe we are not exposed to any significant credit risk on cash and cash equivalents. Due to the short-term duration of our investment portfolio and the low risk profile of our investments, an immediate 100 basis point change in interest rates would not have a material effect on the fair market value of our portfolio.

Interest Rate Risk

We are subject to risk from adverse changes in interest rates, primarily relating to our investing of excess funds in cash equivalents bearing variable interest rates, which are tied to various market indices. Our future investment income will vary due to changes in interest rates. At December 31, 2012, a 10% increase or decrease in interest rates would not have a material impact on our future earnings, fair values, or cash flows related to investments in cash equivalents.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

American Public Education, Inc. and Subsidiary

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders

American Public Education, Inc.

We have audited the accompanying consolidated balance sheets of American Public Education, Inc. and Subsidiary as of December 31, 2012 and 2011, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the financial statement schedule of American Public Education, Inc. and Subsidiary listed in Item 15(a). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Public Education, Inc. and Subsidiary as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), American Public Education, Inc. and Subsidiary's internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 28, 2013 expressed and unqualified opinion on the effectiveness of American Public Education, Inc. and Subsidiary's internal control over financial reporting.

/s/ McGladrey, LLP

Vienna, Virginia

February 28, 2013

Consolidated Balance Sheets

	As of December 31, 2011	2012
	(In thousands, except per share amounts)	
Assets		
Current assets:		
Cash and cash equivalents	$119,006	$114,901
Accounts receivable, net of allowance of $4,996 in 2011 and $11,106 in 2012	9,499	10,428
Prepaid expenses	4,961	4,290
Income tax receivable	1,603	4,953
Deferred income taxes	3,653	6,502
Total current assets	138,722	141,074
Property and equipment, net	58,759	82,840
Note receivable	—	6,000
Investment	—	6,664
Other assets	1,410	1,025
Total assets	$198,891	$237,603
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$16,318	$17,251
Accrued liabilities	14,486	12,042
Deferred revenue and student deposits	25,884	25,777
Total current liabilities	56,688	55,070
Deferred income taxes	8,370	11,380
Total liabilities	65,058	66,450
Commitments and contingencies (Note 3 and 7)		
Stockholders' equity:		
Preferred Stock, $.01 par value; Authorized shares - 10,000; no shares issued or outstanding	—	—
Common Stock, $.01 par value; authorized shares - 100,000; 17,844 issued and outstanding in 2011; 17,752 issued and outstanding in 2012	178	178
Additional paid-in capital	147,053	157,449
Retained earnings (accumulated deficit)	(13,398)	13,526
Total stockholders' equity	133,833	171,153
Total liabilities and stockholders' equity	$198,891	$237,603

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

Consolidated Statements of Income

	Year Ended December 31,		
	2010	2011	2012
	(In thousands, except per share amounts)		
Revenues	$198,174	$260,377	$313,516
Costs and expenses:			
Instructional costs and services	75,309	95,216	110,192
Selling and promotional	34,296	44,713	59,761
General and administrative	32,045	48,350	63,615
Depreciation and amortization	6,502	9,239	11,146
Total costs and expenses	148,152	197,518	244,714
Income before interest income and income taxes	50,022	62,859	68,802
Interest income, net	111	109	135
Income from operations before income taxes	50,133	62,968	68,937
Income tax expense	20,265	22,211	26,528
Investment loss, net of tax	$—	$—	(86)
Net income	$29,868	$40,757	$42,323
Net income attributable to common stockholders per common share:			
Basic	$1.63	$2.28	$2.38
Diluted	$1.59	$2.23	$2.35
Weighted average number of shares outstanding:			
Basic	18,281	17,877	17,772
Diluted	18,837	18,295	18,041

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

Consolidated Statement of Stockholders' Equity

(In thousands, except shares)

	Preferred Stock		Common Stock		Repurchased Stock		Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount			
Balance as of December 31, 2009	—	$ —	18,275,655	$ 183	—	$ —	$ 136,380	$ (54,545)	$ 82,018
Stock issued for cash	—	—	322,134	3	—	—	1,118	—	1,121
Stock issued for director compensation	—	—	4,424	—	—	—	174	—	174
Repurchased shares of common and restricted stock from stockholders			(9,625)	—	(682,046)	(19,966)	(274)		(20,240)
Stock-based compensation	—	—	—	—	—	—	2,805	—	2,805
Repurchased and retired shares of common stock	—	—	—	—	—	—	—	—	—
Excess tax benefit from stock based compensation	—	—	—	—	—	—	1,554	—	1,554
Net income	—	—	—	—	—	—	—	29,868	29,868
Balance as of December 31, 2010	—	—	18,592,588	186	(682,046)	(19,966)	141,757	(24,677)	97,300
Stock issued for cash	—	—	155,472	1	—	—	909	—	910
Stock issued for director compensation	—	—	3,540	—	—	—	139	—	139
Repurchased shares of common and restricted stock from stockholders	—	—	(6,050)	—	(219,208)	(9,521)	(224)	—	(9,745)
Stock-based compensation	—	—	—	—	—	—	3,189	—	3,189
			(901,254)	(9)	901,254	29,487	—	(29,478)	—

Repurchased and retired shares of common stock									
Excess tax benefit from stock based compensation	—	—	—	—	—	—	1,283	—	1,283
Net income	—	—	—	—	—	—	—	40,757	40,757
Balance as of December 31, 2011	—	—	17,844,296	178	—	—	147,053	(13,398)	133,833
Stock issued for cash	—	—	408,739	5	—	—	4,053	—	4,058
Stock issued for director compensation	—	—	3,098	—	—	—	116	—	116
Repurchased shares of common and restricted stock from stockholders	—	—	(10,697)	—	(493,491)	(15,399)	(457)	—	(15,856)
Stock-based compensation	—	—	—	—	—	—	3,818	—	3,818
Repurchased and retired shares of common stock	—	—	(493,491)	(5)	493,491	15,399	—	(15,399)	(5)
Excess tax benefit from stock based compensation	—	—	—	—	—	—	2,866	—	2,866
Net income	—	—	—	—	—	—	—	42,323	42,323
Balance as of December 31, 2012	—	$ —	17,751,945	$ 178	—	$ —	$ 157,449	$ 13,526	$ 171,153

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

Consolidated Statements of Cash Flows

	2010	Year Ended December 31, 2011 (In thousands)	2012
Operating activities			
Net income	$29,868	$40,757	$42,323
Adjustments to reconcile net income to net cash provided by operating activities			
Increase in allowance for doubtful accounts	154	3,946	6,110
Depreciation and amortization	6,502	9,239	11,146
Stock-based compensation	2,805	3,189	3,818
Loss on disposal	129	44	91
Investment loss	—	—	86
Stock issued for director compensation	174	139	116
Deferred income taxes	1,811	(867)	161
Changes in operating assets and liabilities:			
Accounts receivable	(1,759)	(3,176)	(7,039)
Prepaid expenses and other assets	(1,312)	(1,112)	1,080
Income tax receivable	83	(823)	(3,350)
Accounts payable	2,666	6,896	933
Accrued liabilities	1,346	5,137	(2,444)
Deferred revenue and student deposits	4,611	7,069	(107)
Net cash provided by operating activities	47,078	70,438	52,924
Investing activities			
Capital expenditures	(22,454)	(24,925)	(35,014)
Investment	—	—	(6,750)
Note receivable	—	—	(6,000)
Capitalized program development costs and other assets	(573)	(307)	(328)
Net cash used in investing activities	(23,027)	(25,232)	(48,092)
Financing activities			
Cash paid for repurchase of common/restricted stock	(20,240)	(9,745)	(15,861)
Cash received from issuance of common stock , net of issuance costs	1,121	910	4,058
Excess tax benefit from stock based compensation	1,554	1,283	2,866
Net cash used in financing activities	(17,565)	(7,552)	(8,937)
Net increase (decrease) in cash and cash equivalents	6,486	37,654	(4,105)
Cash and cash equivalents at beginning of period	74,866	81,352	119,006
Cash and cash equivalents at end of period	$81,352	$119,006	$114,901
Supplemental disclosures of cash flow information			
Income taxes paid	$16,819	$22,619	$26,851

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

Notes to Consolidated Financial Statements

Note 1. Nature of Business and Significant Accounting Policies

Nature of business. American Public Education, Inc. (“APEI”) together with its subsidiary (the “Company”) is a provider of exclusively online postsecondary education directed primarily at the needs of the military and public service communities that operates in one reportable segment. APEI has one subsidiary, American Public University System, Inc. (the “APUS”), a West Virginia corporation, which is a regionally accredited post-secondary online university that includes American Military University and American Public University.

APUS achieved regional accreditation in May 2006 with The Higher Learning Commission of the North Central Association of Colleges and Schools and became eligible for participation in federal student aid programs under Title IV of the Higher Education Act of 1965, which the Company refers to as Title IV programs, for classes beginning in November 2006.

A summary of the Company’s significant accounting policies follows:

Basis of accounting. The accompanying financial statements are presented in accordance with the accrual basis of accounting, whereby revenue is recognized when earned and expenses are recognized when incurred.

Principles of consolidation. The accompanying consolidated financial statements include accounts of APEI and its wholly-owned subsidiary. All material inter-company transactions and balances have been eliminated in consolidation.

Cash and cash equivalents. The Company considers all highly liquid investments with original maturities of ninety days or less when purchased to be cash equivalents.

Accounts receivable. Course registrations are recorded as deferred revenue and accounts receivable at the time students begin a class. Students may remit tuition payments through the online registration process at any time or they may elect various payment options, which can delay the receipt of payment up until the class starts or longer. These other payment options include payments by sponsors, alternative loans, financial aid, or a tuition assistance program that remits payments directly to the Company. When a student remits payment after a class has begun, accounts receivable is reduced. If payment is made prior to the start of class, the payment is recorded as a student deposit, and the student is provided access to the classroom when classes start. If one of the various other payment options are confirmed as secured, the student is provided access to the classroom. If no receipt is confirmed or payment option secured, the student will be dropped from the class. Therefore, billed amounts represent invoices that have been prepared and sent to students or their sponsor, lender, financial aid, or tuition assistance program according to the billing terms agreed upon in advance. The Department of Defense, or DoD, tuition assistance program is billed by branch of service on a course-by-course basis when a student starts class, whereas federal financial aid programs are billed based on the classes included in a student’s semester. Billed accounts receivable are considered past due if the invoice has been outstanding more than 30 days. The allowance for doubtful accounts is based on management’s evaluation of the status of existing accounts receivable. Recoveries of receivables previously written off are recorded when received. We do not charge interest on our past due accounts receivable.

Property and equipment. Property and equipment is carried at cost less accumulated depreciation. Depreciation and amortization are calculated on a straight-line basis over the estimated useful lives of the assets. Partnership At a Distance, or PAD, is a customized student information and services system that manages admissions, online orientation, course registrations, tuition payments, grade reporting, progress toward degrees, and various other functions. Costs associated with the project have been capitalized in accordance with Financial Accounting Standards

Board Accounting Standards Codification (FASB ASC) Topic 350, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, and classified as property and equipment. These costs are amortized over the estimated useful life of five years. The Company capitalizes the costs for program development. Costs are transferred to property and equipment upon completion of each program and amortized over an estimated life not to exceed three years.

Investment. On September 30, 2012, the Company made a $6.8 million or approximately 19.9% investment in preferred stock of NWHW Holdings, Inc., which in turn acquired New Horizons Worldwide, Inc.("New Horizons"). New Horizons is a global IT training company operating over 300 locations around the world through franchise arrangements in 45 states and 70 countries. In connection with the investment, APEI is entitled to certain rights, including right to representation on the Board of Directors of NWHW Holdings. The Company recorded the investment under the equity method and will recognize its share of earnings or losses in the investee in the periods for which they are reported with a corresponding adjustment in the carrying amount of the investment.

Note Receivable. In connection with the Company's minority investment in NWHW Holdings, Inc., the Company extended $6.0 million in credit to New Horizons in exchange for a subordinated note. The note matures on September 28, 2018 with monthly interest payments of 5.0% per annum during the first five years of the note and interest payments of 6.0% per annum in the sixth year. The Company evaluates the loan receivable by analyzing the borrower's creditworthiness, cash flows and financial status, and the condition and estimated value of the collateral. The Company considers a loan to be impaired when, based upon current information and events, it believes it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement.

Valuation of long-lived assets. The Company accounts for the valuation of long-lived assets under FASB ASC Topic 360, Accounting for the Impairment or Disposal of Long-Lived Assets. FASB ASC Topic 360 requires that long-lived assets and certain identifiable intangible assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of the long-lived asset is measured by a comparison of the carrying amount of the asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets to be disposed of are reportable at the lower of the carrying amount or fair value, less costs to sell.

Revenue recognition. The Company records all tuition as deferred revenue when students begin a class. At the beginning of each class, revenue is recognized on a pro rata basis over the period of the class, which is either eight or sixteen weeks. This results in the Company's balance sheet including future revenues that have not yet been earned as deferred revenue for classes that are in progress. Students who request to be placed on program hold are required to complete or withdraw from the courses prior to being placed on hold. Other revenue includes charges for transcript credit evaluation, which includes assistance in securing official transcripts on behalf of the student in addition to evaluating transcripts for transfer credit. Students also are charged withdrawal, graduation, late registration, transcript request and comprehensive examination fees, when applicable. In accordance with FASB ASC Topic 605-50, Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor, other fees also include book purchase commissions we receive for graduate student book purchases and ancillary supply purchases students make directly from our preferred book vendor. Tuition revenues vary from period to period based on the number of net course registrations. Students may remit tuition payments through the online registration process at any time or they may elect various payment options, including payments by sponsors, alternative loans, financial aid, or the DoD tuition assistance program that remits payments directly to the Company. These other payment options can delay the receipt of payment up until the class starts or longer, resulting in the recording of a receivable from the student and deferred revenue at the beginning of each session. Tuition revenue for sessions in progress that has not been yet earned by the Company is presented as deferred revenue in the accompanying balance sheet.

The Company refunds 100% of tuition for courses that are dropped by students before the conclusion of the first seven days of a course. Because courses begin the first Monday of every month and penalty free drops occur by the second Monday of every month, the Company does not recognize revenue for dropped courses. After a course begins and if a student does not drop their course, the following refund policy is used:

8-Week Course- Tuition Refund Schedule

Withdrawal Request	Date Tuition Refund Percentage
Before or During Week 1	100%
During Week 2	75%
During Weeks 3 and 4	50%
During Weeks 5 through 8	No Refund

16-Week Course- Tuition Refund Schedule

Withdrawal Request	Date Tuition Refund Percentage
Before or During Week 1	100%
During Week 2	100%
During Weeks 3 and 4	75%
During Weeks 5 through 8	50%
During Weeks 9 through 16	No Refund

Deferred revenue and student deposits at December 31, 2011 and 2012 consisted of the following:

	As of December 31,	
	2011	2012
	(In thousands)	
Deferred revenue	$13,753	$15,093
Student deposits	12,131	10,684
Total deferred revenue and student deposits	$25,884	$25,777

The Company provides scholarships to certain students to assist them financially and promote their registration. Scholarship assistance of $1,044,000, $2,155,000 and $2,832,000 was provided for the years ended December 31, 2010, 2011 and 2012, respectively, and are included as a reduction to revenue in the accompanying statements of income.

Advertising costs.   Advertising costs are expensed as incurred. Advertising expenses for the years ended December 31, 2010, 2011 and 2012 were $22,046,000, $29,306,000 and $41,929,000 respectively, and are included in selling and promotion costs in the accompanying statements of income.

Income taxes.   Deferred taxes are determined using the liability method, whereby, deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. As those differences reverse, they will enter into the determination of future taxable income. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

There were no material uncertain tax positions as of December 31, 2011 and 2012. Interest and penalties associated with uncertain income tax positions would be classified as income tax expense. The Company has not recorded any material interest or penalties during any of the years presented.

Stock-based compensation.   The Company applies FASB ASC Topic 718, Share-Based Payment, which requires companies to expense share-based compensation based on fair value.

The following amounts of stock-based compensation have been included in the operating expense line-items indicated:

	Year Ended December 31,		
	2010	2011	2012
		(in thousands)	
Instructional costs and services	$717	$893	$896
Selling and promotional	224	324	378
General and administrative	1,864	1,972	2,544
Total stock-based compensation expense	$2,805	$3,189	$3,818

Income per common share.   Basic net income per common share is based on the weighted average number of shares of common stock outstanding during the period. Diluted net income per common share also increases the shares used in the per share calculation by the dilutive effects of options, warrants, and restricted stock.

There were no outstanding options to purchase common shares that were excluded in the computation of diluted net income per common share for the years ended December 31, 2011 and 2010 and 265,965 anti-dilutive stock options excluded from the calculation for the year ended December 31, 2012.

Fair value of financial instruments. The methods and significant assumptions used to estimate the fair values of financial instruments are as follows: the carrying amounts of cash and cash equivalents, tuition receivable, accounts payable, and accrued liabilities approximate fair value because of the short maturity of these instruments.

Financial risk. The Company maintains its cash and cash equivalents in bank deposit accounts, which at times may exceed Federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents.

Estimates. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Note 2. Property and Equipment

Property and equipment at December 31, 2011 and 2012 consisted of the following:

	Useful Life	2011	2012
		(in thousands)	
Land	—	$4,705	$6,863
Building and building improvements	27.5 - 39 years	28,428	44,512
Leasehold improvements	up to 7 years	2,183	2,125
Office equipment	5 years	1,561	2,306
Computer equipment	3 years	12,648	16,098
Furniture and fixtures	7 years	4,842	6,778
Vehicles	5 years	107	107
Software development	5 years	30,169	39,577
Program development	3 years	2,590	2,918
		87,233	121,284
Accumulated depreciation and amortization		28,474	38,444
		$58,759	$82,840

During the years ended December 31, 2010, 2011 and 2012, the Company recorded $6,352,000, $9,089,000 and $10,996,000 respectively, in depreciation expense. In addition, the Company recorded $150,000 in amortization expense during the years ended December 31, 2010, 2011 and 2012, respectively, related to other assets.

Note 3. Operating Leases

The Company leases office space in Virginia and West Virginia under operating leases that expire through March 2015. Rent expense related to these operating leases amounted to $1,467,000, $1,634,000 and $1,656,000 for the years ended December 31, 2010, 2011 and 2012, respectively. The minimum rental commitment under the operating leases is due as follows:

Years Ending December 31,

	(in thousands)
2013	$ 1,081
2014	924
2015	233
2016	—
2017	—
	$ 2,238

Note 4. Income Taxes

The components of the income tax expense for the years ended December 31, 2009, 2010 and 2011 were as follows:

	2010	2011 (in thousands)	2012
Current income tax expense:			
Federal	$14,962	$20,790	$22,937
State	3,492	2,288	3,430
	18,454	23,078	26,367
Deferred tax expense:			
Federal	1,622	(290)	150
State	189	(577)	11
	1,811	(867)	161
	$20,265	$22,211	$26,528

The tax effects of principal temporary differences are as follows:

	2011	2012
	(in thousands)	
Deferred tax assets:		
Property and equipment	$1,410	$2,925
Stock option compensation expense	1,778	1,765
Allowance for doubtful accounts	1,907	4,211
Accrued vacation and severance	384	485
Restricted stock	519	863
Investment	—	41
	5,998	10,290
Deferred tax liabilities:		
Income tax deductible capitalized software development costs	(9,779)	(14,346)
Prepaid expenses	(936)	(822)
	(10,715)	(15,168)
	$(4,717)	$(4,878)

The deferred tax amounts above have been classified on the accompanying balance sheets as of December 31, 2011 and 2012, as follows:

	2011	2012
	(in thousands)	
Current assets	$3,653	$6,502
Non-current liabilities	$(8,370)	$(11,380)

Income tax expense differs from the amount of tax determined by applying the United States Federal income tax rates to pretax income and loss due to permanent tax differences, research and development tax credits related to capitalized software development costs, energy tax credits and the application of state apportionment laws, as follows:

	2010		2011		2012	
	Amount	%	Amount	%	Amount	%
			(in thousands)			
Tax expense at statutory rate	$17,546	35.00	$22,039	35.00	$24,135	35.00
State taxes, net	2,392	4.77	1,112	1.77	2,241	3.25
Permanent differences	141	0.28	96	0.15	154	0.22
Other	186	0.37	(1,036)	(1.65)	(2)	—
	$20,265	40.42	$22,211	35.27	$26,528	38.47

Permanent differences in the table above are mainly attributable to nondeductible meals and entertainment expenses and non-deductible employer contributions to the Employee Stock Purchase Plan (“ESPP”).

Other primarily consists of research and development and energy tax credits. In 2011, the Company recorded research and development credits of $499,000 and energy credits of $664,000. The Company undertakes research and development activities in connection with its learning programs. The energy credits are in connection with solar panel and charging stations for its facility in Charles Town. In 2011, the state effective tax rate decreased based on a review of the application of state apportionment factor laws to its revenue producing activities.

The Company is subject to U.S. federal income taxes as well as income tax of multiple state jurisdictions. For federal and state tax purposes, tax years 2009-2012 remain open to examination.

Note 5. Other Employee Benefits

The Company has established a tax deferred 401(k) retirement plan that provides retirement benefits to all of its eligible employees. The participants may elect to contribute up to 60% of their gross annual earnings not to exceed ERISA and IRS limits. The plan provides for Company discretionary profit sharing contributions at matching percentages. Employees immediately vest 100% in all salary reduction contributions and employer contributions. On June 20, 2008, the Company filed a Form S-8 to register 100,000 shares of common stock that may be purchased in the open market and subsequently issued pursuant to the retirement plan. The Company made discretionary contributions to the plan of $1,528,000, $2,015,000 and $2,447,000 for the years ended December 31, 2010, 2011 and 2012, respectively.

In November 2007, the Company adopted the American Public Education, Inc. Employee Stock Purchase Plan. The ESPP was implemented effective July 1, 2008, with quarterly enrollment periods. Participants may only enter the plan and establish their withholdings at the start of an enrollment period. They may withdraw from the plan and end payroll deductions any time up to five days before the purchase date and funds will be returned to them. Under the ESPP, eligible employees may purchase shares of the Company’s common stock, subject to certain limitations, at 85% of its fair market value on the last day of the quarterly period. The total value of contributions per participant may not exceed $21,000 annually (or the value of the common stock cannot exceed $25,000). The aggregate number of shares of common stock that may be made available for purchase by participating employees under the ESPP is 100,000 shares. Shares purchased in the open market for employees for the years ended December 31, 2011 and 2012 were as follows:

Purchase Date	Shares	Common Stock	Purchase Price	Compensation Expense

			Fair Value		
March 31, 2011	4,158	$40.45	$34.38	$	25,239
June 30, 2011	3,739	$44.51	$37.83	$	24,977
September 30, 2011	5,655	$34.00	$28.90	$	28,841
December 31, 2011	4,113	$43.28	$36.79	$	26,693
Total/Weighted Average	17,665	$39.90	$33.92	$	105,750
March 31, 2012	4,749	$38.00	$32.30	$	27,069
June 30, 2012	6,214	$32.00	$27.20	$	29,827
September 30, 2012	4,517	$36.43	$30.97	$	24,663
December 31, 2012	5,093	$36.12	$30.70	$	27,604
Total/Weighted Average	20,573	$35.38	$30.07	$	109,163

Note 6. Stockholders' Equity

Stock Incentive Plans

On March 15, 2011, the Board of Directors adopted the American Public Education, Inc. 2011 Omnibus Incentive Plan (the “2011 Incentive Plan”), and APEI’s stockholders approved the 2011 Incentive Plan on May 6, 2011, at which time the 2011 Incentive Plan became effective. Upon effectiveness of the 2011 Incentive Plan, APEI ceased making awards under the 2007 Omnibus Incentive Plan. The 2011 Incentive Plan allows APEI to grant up to 2,000,000 shares plus any shares of common stock that are subject to outstanding awards under the 2002 Stock Plan or the 2007 Incentive Plan that terminate due to expiration, forfeiture, cancellation or otherwise without the issuance of such shares. As of December 31, 2012, there were 730,758 shares subject to outstanding awards under the 2002 Stock Plan and the 2007 Incentive Plan and 96,721 shares subject to outstanding awards under the 2011 Incentive Plan. Awards under the 2011 Incentive Plan may include the following award types: stock options, which may be either incentive stock options or non-qualified stock options; stock appreciation rights; restricted stock; restricted stock units; dividend equivalent rights; performance shares; performance units; cash-based awards; other stock-based awards, including unrestricted shares; or any combination of the foregoing. Prior to 2012, the Company used a mix of stock options and restricted stock, but in 2012 did not issue any stock options.

For the years ended December 31, 2010, 2011 and 2012, the Company recognized $2,805,000, $3,189,000 and $3,818,000 in stock-based compensation expense as required under FASB ASC Topic 718 and a total income tax benefit of $1,063,000, $1,254,000 and $1,512,000. respectively.

Stock-based compensation expense related to restricted stock grants is expensed over the vesting period using the straight-line method for Company employees and the graded-vesting method for members of the Board of Directors and is measured using APEI’s stock price on the date of grant. The fair value of each option award is estimated at the date of grant using a Black-Scholes option-pricing model that uses the assumptions noted in the following table. Prior to 2012, we calculated the expected term of stock option awards using the “simplified method” in accordance with Staff Accounting Bulletins No. 107 and 110 because we lacked historical data and were unable to make reasonable expectations regarding the future. We also estimate forfeitures of share-based awards at the time of grant and revise such estimates in subsequent periods if actual forfeitures differ from original projections. We make assumptions with respect to expected stock price volatility based on the average historical volatility of peers with similar attributes. In addition, we determine the risk free interest rate by selecting the U.S. Treasury five-year constant maturity, quoted on an investment basis in effect at the time of grant for that business day. Estimates of fair value are subjective and are not intended to predict actual future events, and subsequent events are not indicative of the reasonableness of the original estimates of fair value made under FASB ASC Topic 718.

The following table sets forth the assumptions used in calculating the fair value at the date of grant of each option award granted:

	2010	2011	2012
Expected volatility	26.46%	39.04%	—%
Expected dividends	—	—	—
Expected term, in years	4.5	4.5	—
Risk-free interest rate	2.65%	2.01%	—%
Weighted-average fair value of options granted during the year	$9.42	$13.22	$—

A summary of the status of the Company's Stock Incentive Plan as of December 31, 2012 and the changes during the periods then ended is as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Contracual Life (years)	Aggregate Intrinsic Value (in thousands)
Outstanding, December 31, 2011	1,067,511	$21.22		
Options granted	—	$—		
Awards exercised	(369,918)	$10.97		
Options forfeited	(6,511)	$34.03		
Outstanding, December 31, 2012	691,082	$21.22	3.86	$6,926
Exercisable, December 31, 2012	513,201	$23.10	3.57	$6,849

The following table summarizes information regarding stock option exercises:

	2010	2011	2012
		(In thousands)	
Proceeds from stock options exercised	$1,121	$910	$4,058
Intrinsic value of stock options exercised	$9,841	$4,574	$9,580
Tax benefit from exercises	$2,048	$1,786	$3,459

As of December 31, 2012 there was $3,841,000 of total unrecognized compensation cost, representing $753,000 of unrecognized compensation cost associated with share-based compensation arrangements, and $3,088,000 of unrecognized compensation cost associated with non-vested restricted stock. That total remaining cost is expected to be recognized over a weighted average period of .66 and 1.54 years, respectively.

There were 265,965 outstanding options to purchase common shares that were excluded in the computation of diluted net income per common share for the year ended December 31, 2012 and no outstanding options to purchase common shares that were excluded in the computation of diluted net income per common share for years ended December 31, 2011 and, 2010, respectively.

Restricted Stock

The table below sets forth the restricted stock activity for the year ended December 31, 2012:

	Number of Shares	Weighted Average Grant Price and Fair Value
Non vested, December 31, 2011	79,075	$37.44
Shares granted	97,240	40.09
Vested shares	(38,821)	37.80
Shares forfeited	(1,097)	38.87
Non vested, December 31, 2012	136,397	$39.21

There were no shares of restricted stock excluded in the computation of diluted net income per common share for the year ended December 31, 2012. The Company recognized an income tax benefit of $948,000, $605,000 and $538,000 from vested shares for the year ended December 31, 2012, 2011 and 2010, respectively.

Employees are provided the option to forfeit to the Company shares equivalent to the minimum statutory tax withholding required to be paid when the restricted stock vests. During the year ended December 31, 2010, 2011 and 2012 the Company accepted for forfeiture 9,625 shares for $274,000 and 6,050 shares for $224,000 and 10,697 shares for $456,000, respectively, under this arrangement.

Repurchase

During the year ended December 31, 2012, the Company repurchased 493,491 shares of the Company's common stock, par value $0.01 per share. The chart below provides further detail as to the Company's repurchases during the period.

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)(3)	Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (2)(3)
January 1, 2012 – January 31, 2012	—	$—	—	87,033	—
February 1, 2012 – February 29, 2012	—	$—	—	87,033	—
March 1, 2012 – March 31, 2012	87,033	$39.02	87,033	—	—
April 1, 2012 – April 30, 2012	—	$—	87,033	—	$—
May 14, 2012	—	$—	87,033	—	$20,000,000
May 1, 2012 – May 31, 2012	40,000	$28.70	127,033	—	18,851,824
June 1, 2012 – June 30, 2012	113,426	$29.42	240,459	—	15,515,168
July 1, 2012 - July 31, 2012	73,410	$28.69	313,869	—	13,409,230
August 1, 2012 - August 31, 2012	82,467	$27.23	396,336	—	11,163,298
September 1, 2012 - September 30, 2012	13,300	$32.98	409,636	—	10,724,643
October 1, 2012 to October 31, 2012	—	$—	409,636	—	10,724,643
November 1, 2012 to November 30, 2012	83,855	$32.58	493,491	—	7,992,647
December 1, 2012 to December 31, 2012	—	$—	493,491	—	7,992,647
Total	493,491	$31.21	493,491	—	$7,992,647

During the year ended December 31, 2011, the Company repurchased 219,208 shares of the Company's common stock, par value $0.01 per share. The chart below provides further detail as to the Company's repurchases during the period.

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs

January 1, 2011 – January 31, 2011	—	—	—	219,208
February 1, 2011 – February 28, 2011	—	$—	—	219,208
March 1, 2011 – March 31, 2011	32,000	$41.21	32,000	187,208
April 1, 2011 - April 30, 2011	40,000	$41.56	40,000	147,208
May 1, 2011 to May 31, 2011	42,000	$43.51	42,000	105,208
June 1, 2011 to June 30, 2011	44,000	$42.53	44,000	61,208
July 1, 2011 to July 31, 2011	40,000	$47.19	40,000	21,208
August 1, 2011 to August 31, 2011	21,208	$45.00	21,208	—
September 1, 2011 to September 30, 2011	—	—	—	—
October 1, 2011 to October 31, 2011	—	—	—	—
November 1, 2011 to November 30, 2011	—	—	—	—
December 1, 2011 to December 31, 2011	—	—	—	—
Total	219,208	$43.43	219,208	—

During the years ended December 31, 2012 and 2011, the Company retired 493,491 and 901,254 shares of common stock that had been previously repurchased and held in our treasury, respectively.

Note 7. Contingencies

From time to time the Company may be involved in litigation in the normal course of its business. Management does not expect that the resolution of these matters would have a material adverse effect on the Company’s business, operations, financial condition or cash flows.

Note 8. Concentration

Approximately 50%, 41% and 38% of the Company’s 2010, 2011 and 2012 revenues, respectively, were derived from students who receive tuition assistance from tuition assistance programs sponsored by the United States Department of Defense. Approximately 8%, 9% and 13% of the Company’s 2010, 2011 and 2012 revenues, respectively, were derived from students who were eligible for veterans benefits. A reduction in military tuition assistance or veterans benefits could have a significant impact on the Company’s operations. In October of 2006, APUS was approved for participation in Title IV programs, allowing the Company to participate in federal student aid programs. Approximately, 24%, 37% and 36% of the Company’s 2010, 2011 and 2012 revenues respectively, were derived from students who received federal student aid.

Note 9. Segment Information

The Company is organized and operates as one operating segment. In accordance with FASB ASC Topic 280, Segment Reporting, the chief operating decision-maker has been identified as the Chief Executive Officer. The Chief Executive Officer reviews operating results to make decisions about allocating resources and assessing performance for the entire company. Because the Company operates in one segment and provides one group of similar services, all financial segment and product line information required by FASB ASC Topic 280 can be found in the consolidated financial statements.

Note 10. Subsequent Events

We have reviewed our business activities and have no additional subsequent events to report.

Note 11. Quarterly Financial Summary (unaudited)

The following unaudited consolidated interim financial information presented should be read in conjunction with other information included in the Company's consolidated financial statements. The following unaudited consolidated financial information reflects all adjustments necessary for the fair presentation of the results of interim periods. The following tables set forth selected unaudited quarterly financial information for each of the Company's last eight quarters:

	First	Second	Third	Fourth
	(in thousands, except per share data)			
2012				
Revenues	$ 75,822	$ 74,572	$ 77,122	$ 86,000
Income before income taxes	14,891	14,958	17,548	21,540
Net income	9,083	9,241	10,824	13,175
Net income per common share:				
Basic	$ 0.51	$ 0.52	$ 0.61	$ 0.73
Diluted	$ 0.50	$ 0.51	$ 0.60	$ 0.74
2011				
Revenues	$ 58,664	$ 60,795	$ 65,251	$ 75,667
Income before income taxes	13,098	14,936	15,069	19,865
Net income	7,857	8,976	10,939	12,985
Net income per common share:				
Basic	$ 0.44	$ 0.50	$ 0.61	$ 0.73
Diluted	$ 0.43	$ 0.49	$ 0.60	$ 0.71

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We have carried out an evaluation, under the supervision and the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Securities Exchange Act), as of December 31, 2011. Based upon that evaluation, our principal executive officer and principal financial officer concluded that, as of the end of that period, our disclosure controls and procedures are effective in providing reasonable assurance that (a) the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Security and Exchange Commission's rules and forms, and (b) such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting.

There were no changes in the Company’s internal controls over financial reporting during the fourth quarter of 2012 that have materially affected or are reasonably likely to materially affect the Company’s internal control over financial reporting.

MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2012 and 2011. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control — Integrated Framework.

Based on its assessment, management concluded that, as of December 31, 2012, our internal control over financial reporting is effective based on those criteria.

Our independent auditors, McGladrey, LLP, have issued an audit report on our internal control over financial reporting. This report appears below.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders

American Public Education, Inc.

We have audited American Public Education, Inc. and Subsidiary's internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. American Public Education, Inc. and Subsidiary's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, American Public Education, Inc. and Subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of American Public Education, Inc. and Subsidiary as of December 31, 2012 and 2011, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2012, and our report dated February 28, 2013 expressed an unqualified opinion.

/s/ McGladrey, LLP

Vienna, VA

February 28, 2013

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

Executive Officers

Pursuant to General Instruction G(3) of Form 10-K, information regarding our executive officers is set forth in Part I of this annual report under the caption Item 1. “Executive Officers of American Public Education, Inc.”

Code of Ethics

As part of our system of corporate governance, our board of directors has adopted a Code of Business Conduct and Ethics that is applicable to all of our employees, and also contains provisions only applicable to our Chief Executive Officer and senior financial officers. Our Code of Business Conduct and Ethics is available on the Corporate Governance page of our website at http://www.americanpubliceducation.com. We intend to satisfy any disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or waiver from, a provision of the Code of Business Conduct and Ethics that applies to our chief executive officer or senior financial officers, by posting such information on our website at the address above.

Additional Information

The additional information regarding directors, executive officers and corporate governance required by this Item is hereby incorporated by reference from the information contained under the captions “Corporate Governance Standards and Director Independence,” “Board Committees and Their Functions,” “Director Nominations and Communication with Directors,” “Proposal No. 1 — Election of Directors” and “Section 16(a) Beneficial Ownership Reporting and Compliance” in the Company’s Proxy Statement, which will be filed with the SEC no later than 120 days following December 31, 2012 with respect to our 2013 Annual Meeting of Stockholders.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is hereby incorporated by reference from the information contained under the captions “Director Compensation” and “Executive Compensation” in the Company’s Proxy Statement, which will be filed with the SEC no later than 120 days following December 31, 2012 with respect to our 2013 Annual Meeting of Stockholders.

On February 28, 2012, the Board of Directors of the Company approved and adopted the APUS Non-Qualified Plan, pursuant to which the Company will credit to eligible participants an amount equal to the difference between (1) the matching contribution that such participant would have received for the calendar year under the Company’s 401(k) Plan had the limitation under Code Section 401(a)(17) not applied and (2) the matching contribution that such participant actually received under the Company’s 401(k) Plan, as well as any additional discretionary amounts that the Company may contribute for the benefit of such participant.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is hereby incorporated by reference from the information contained under the captions “Beneficial Ownership of Common Stock” and “Equity Compensation Plan Information” in the Company’s Proxy Statement, which will be filed with the SEC no later than 120 days following December 31, 2012 with respect to our 2013 Annual Meeting of Stockholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS, AND DIRECTOR

The information required by this Item is hereby incorporated by reference from the information contained under the captions “Certain Relationships and Related Persons Transactions” and “Board Independence” in the Company’s Proxy Statement, which will be filed with the SEC no later than 120 days following December 31, 2012 with respect to our 2012 Annual Meeting of Stockholders.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is hereby incorporated by reference from the information contained under the captions “Principal Accountant Fees and Services” and “Audit Committee’s Pre-Approval Policies and Procedures” in the Company’s Proxy Statement, which will be filed with the SEC no later than 120 days following December 31, 2012 with respect to our 2013 Annual Meeting of Stockholders.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULE

(a) List of documents filed as part of this annual report on Form 10-K:

(1) The required financial statements are included in Item 8 of Part II of this annual report on Form 10-K.

(2) The required financial statement schedules are included in Item 8 of Part II of this annual report on Form 10-K.

(3) A complete listing of exhibits is included in the Index to Exhibits.

(b) A complete listing of exhibits is included in the Index to Exhibits.

(c) Schedule II: Valuation and Qualifying Accounts.

Other schedules are omitted because they are not required.

AMERICAN PUBLIC EDUCATION, INC.

Schedule II

Valuation and Qualifying Accounts

	Balance at beginning of period	Additions/ (reductions)	Write-offs	Balance at end of period
Year ended December 31, 2012:				
Allowance for receivables	$4,996	$ 13,610	$(7,500)	$11,106
Year ended December 31, 2011:				
Allowance for receivables	$1,050	$ 6,735	$(2,789)	$4,996
Year ended December 31, 2010:				
Allowance for receivables	$896	$ 2,128	$(1,974)	$1,050

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AMERICAN PUBLIC EDUCATION, INC.

Dated: February 28, 2013	By:	/s/ Dr. Wallace E. Boston
	Name:	Dr. Wallace E. Boston
	Title:	President and Chief Executive Officer

Pursuant to the requirement of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Name	Date	Title
/s/ Dr. Wallace E. Boston Dr. Wallace E. Boston	February 28, 2013	President, Chief Executive Officer and Director (Principal Executive Officer)
/s/ Harry T. Wilkins Harry T. Wilkins	February 28, 2013	Executive Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)
/s/ J. Christopher Everett J. Christopher Everett	February 28, 2013	Chairman of the Board of Directors
/s/ F. David Fowler F. David Fowler	February 28, 2013	Director
/s/ Jean C. Halle Jean C. Halle	February 28, 2013	Director
/s/ Timothy J. Landon Timothy J. Landon	February 28, 2013	Director
/s/ Barbara G. Fast Barbara G. Fast	February 28, 2013	Director
/s/ Timothy T. Weglicki	February 28, 2013	Director

Timothy T. Weglicki

/s/ Eric C. Andersen Eric C. Andersen	February 28, 2013	Director

INDEX TO EXHIBITS

Exhibit No.	Exhibit Description
3.1	Fifth Amended Restated Certificate of Incorporation of the Company (1)
3.2	Second Amended and Restated Bylaws of the Company (1)
4.1	Form of certificate representing the Common Stock, $0.01 par value per share, of the Company
10.1+	American Public Education, Inc. 2002 Stock Incentive Plan (2)
10.2+	American Public Education, Inc. 2007 Omnibus Incentive Plan (2)
10.3+	Form of Indemnification Agreement with directors and executive officers (2)
10.4+	Amended and Restated Employment Agreement between the Company and Wallace E. Boston, Jr. dated October 10, 2007 (2)
10.4A+	Amendment dated December 31, 2008, to the Amended and Restated Employment Agreement between the Company and Wallace E. Boston, Jr. dated October 10, 2007 (3)
10.5+	Amended and Restated Employment Agreement between the Company and Harry T. Wilkins dated October 10, 2007
10.5A+	Amendment dated December 31, 2008, to the Amended and Restated Employment Agreement between the Company and Harry T. Wilkins dated October 10, 2007 (3)
10.6+	Separation Agreement dated October 25, 2012 between American Public University System, Inc. and Dale Young (filed herewith)
10.6A+	Consulting Agreement dated January 1, 2013 between American Public University System, Inc. and Dale Young (filed herewith)
10.7+	American Public Education, Inc. Employee Stock Purchase Plan (2)
10.8+	Employment Agreement between the Company and Sharon van Wyk (4)
10.9+	Employment Agreement between the Company and Karan Powell
10.10+	American Public Education, Inc. 2011 Omnibus Incentive Plan (5)
10.11+	APUS Non-Qualified Plan (filed herewith)
21.1	List of Subsidiaries (filed herewith)
23.1	Consent of McGladrey, LLP (filed herewith)
31.1	Certification of Chief Executive officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)
32.1	

	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)

EX-101.INS	XBRL Instance Document
EX-101.SCH	XBRL Taxonomy Extension Schema Document
EX-101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
EX-101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
EX-101.LAB	XBRL Taxonomy Extension Label Linkbase Document
EX-101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Unless otherwise noted, all exhibits are incorporated by reference to the Registrant’s Form S-1 Registration Statement (No. 333-145185), as amended.

+	Management contract or compensatory plan or arrangement.
(1)	Incorporated by reference to exhibit filed with Registrant's Current Report on Form 8-K (File No. 01-33810), filed with the Commission on November 14, 2007.
(2)	Incorporated by reference to exhibit filed with Registrant's Registration Statement on Form S-1 (File No. 333-)145185.
(3)	Incorporated by reference to exhibit filed with Registrant's Annual Report on Form 10-K for the year ended December 31, 2008 (File No. 01-33810), filed with the Commission on March 10, 2009.
(4)	Incorporated by reference to exhibit filed with Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2009 (File No. 01-33810), filed with the Commission on November 5, 2009.
(5)	Incorporated by reference to Exhibit A of the Registrant's 2011 Annual Proxy Statement on Schedule 14A (File No. 01-33810), filed with the Commission on March 22, 2011.