

Statement of

Thomas R. Bloom
Inspector General
U.S. Department of Education

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Subcommittee on Human Resources

Committee on Government Reform and Oversight
United States House of Representatives

Regarding

Department of Education
Management and Programmatic Issues

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Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me to testify about management and programmatic issues at the Department of Education and areas of fraud, waste and abuse we have identified in the Department's programs and operations.

My testimony today will focus on the Student Financial Assistance Programs (SFA programs), that is, the loan and grant programs under Title IV of the Higher Education Act (HEA). As this Subcommittee is well aware from previous hearings as well as Office of Inspector General (OIG) and General Accounting Office (GAO) reports, these programs have consistently been identified as high-risk and the most vulnerable to fraud, waste and abuse. I will highlight three broad risk areas and the following specific issues:

I. Management Information and Delivery Systems

- ! Lack of Integration
- ! Data Integrity Problems
- ! Insufficient Managerial and Technical Skills
- ! NSLDS Cost Overruns
- ! The "Year 2000 Problem"

II. Management and Programmatic Issues

- ! Management of the Two SFA Loan Programs
- ! Need for Measurable Performance Standards
- ! Consolidation of Defaulted Loans
- ! Reconciliation Process in the Direct Loan Program
- ! Monitoring and Oversight of Schools
- ! Implementation of 1992 HEA Amendments
- ! The Departmental Financial Statement Audit
- ! Compliance with the Government Performance and Results Act

III. Areas of Fraud, Waste and Abuse

- ! Need for Income Verification Using IRS Data
- ! Due Diligence Fraud by Lenders
- ! Failure by Schools to Pay Refunds of Grants and Loans
- ! Screening for Prior Defaulters
- ! Improper Claims by Guaranty Agencies
- ! Impact of Ability-to-Benefit Students on School Default Rates
- ! Professional Judgment Fraud and Abuse
- ! Pell Eligibility for High-Default Schools

I. Management Information and Delivery Systems

The Department oversees the delivery of approximately \$40 billion per year in student financial aid and a total \$120 billion portfolio through the use of “stovepipe” information and delivery systems which cost roughly \$300 million per year to operate. These systems are not integrated, do not share a common systems

architecture, and do not provide the timely, accurate and complete data needed to manage effectively the SFA programs and a portfolio of this size. The Department has a number of major improvement initiatives underway to address these problems, but at present it has neither a permanent Chief Information Officer nor a final information resources management strategic plan to provide direction and a cohesive strategy. In addition, we do not believe the Department has a sufficient number of the type and caliber of information systems personnel necessary to complete successfully an undertaking of this magnitude and be ready to operate effectively in the future.

The OIG, GAO, and the Advisory Committee on Student Financial Assistance have all reported on many aspects of these systems problems. Congress has long had concerns in this area; indeed, the HEA itself directs the Department to integrate the National Student Loan Data System (NSLDS) with the Pell Grant databases by January 1, 1994, a deadline which the Department has not met. Legislative accountability initiatives, in particular the Chief Financial Officers Act (CFO Act), the Government Performance and Results Act (GPRA), and the Clinger-Cohen Act, clearly emphasize the need for effective information systems.

Other federal agencies have inadequate information systems and have made costly mistakes in attempting to develop and modernize them. This should serve as a caution to the Department. GAO's high-risk series report on information, management and technology contained recommendations for mitigating risks associated with investment control, system development and technical infrastructure which provide important lessons for the Department and other agencies developing large information systems.

I have designated oversight of SFA program systems development and operations to be one of the OIG's highest priorities and an area where we will concentrate significant resources. I have created a systems audit group to provide oversight of our efforts to review the Department's systems development and implementation. Given the highly complex nature of the systems problems, we are in the process of engaging contractors with the necessary expertise to assist OIG.

Let me summarize some of the information systems-related issues on which we intend to focus attention.

Lack of Integration -- The Department's Office of Postsecondary Education (OPE) currently uses 12 major program delivery and information systems to operate the SFA programs. Additionally, SFA systems interact with the Department's financial management systems which control budget execution, record financial transactions, and manage payments. These program and financial management systems are operated by a multitude of contractors, on a variety of different platforms, using different software. This fragmented data information system simply is not cost effective or capable of providing the quality of data required to manage the large and complex SFA programs and portfolio. Specific examples of the resulting inefficiencies include:

- ! Institutions must report data to multiple systems, often in different formats;
- ! Systems track institutions using different identification numbers;
- ! Institutions must interact with different contractors running the different systems;
- ! Systems maintain redundant data, increasing the storage cost and risk of data inconsistencies; and
- ! "Stovepipe" systems do not provide adequate management information across programs.

It is vital for the Department to develop integrated information systems to allow it to operate effectively and monitor the SFA programs in the next century. This is an area in which significant cost savings can be realized in the long run if timely, smart and forward-thinking decisions are made now about systems design.

The Department's proposed solution for integrating the SFA programs is a project called "Easy Access for Students and Institutions" or "EASI." At this time, the project is at the conceptual stage of developing the architecture that would be necessary for a completely integrated SFA delivery and information system. While I support the intent of Project EASI, I must concur with GAO's recent assessment that "Project EASI has had a tentative start" and that it "is a long-term undertaking" that will not solve the integration problem anytime soon. We believe its successful development and implementation will require a dedicated senior level project manager and technically proficient staff.

Data Integrity of NSLDS and PEPS -- Two crucial databases for the SFA programs are unreliable: the NSLDS and the Postsecondary Education Participants System (PEPS). NSLDS contains information on loan data, and PEPS was designed to contain all information on schools participating in the SFA programs.

We have long known and reported that the Federal Family Education Loan program (FFELP) loan status information received by the Department from guaranty agencies is in many instances inaccurate, and remains so when incorporated into the NSLDS, thereby rendering that database unreliable. In 1996, we

reported that the guaranty agencies' overstatement of the number of FFELP loans in repayment remained in the NSLDS and that there was evidence of loans in an open status with zero balances. We recommended that the Department require guaranty agencies to reconcile loan level data on a monthly basis with the lenders. We also recommended that the Department add an edit check to reject loans with an incorrect status, quantify the rejected loans and require the guaranty agencies to correct the information. The Department has not implemented our recommendations. However, the Department did initiate a major data integrity project in December 1996 which entails visiting guaranty agencies and reconciling their databases to NSLDS. We are currently conducting an audit to determine the reasons for inaccurate data in the NSLDS.

The independent auditors of the Department's financial statements, Price Waterhouse, whose work OIG oversaw, corroborated OIG's findings about NSLDS data inaccuracy. Because of questions about the accuracy of the NSLDS data on FFELP loans received from the guaranty agencies, Price Waterhouse was unable to render an opinion as to whether the Department's loan loss liability estimates for fiscal year 1995 were materially correct. For fiscal year 1996, Price Waterhouse is working with the Department and the guaranty agencies to obtain the necessary information.

Inaccurate loan data limits the Department's ability to use its database to determine the reasonableness of FFELP lender billings for interest and special allowance and may result in the overpayment of loan reinsurance to guaranty agencies. It also impairs the Department's ability to monitor borrowers. While I cannot quantify the excess cost of these inefficiencies precisely, we have reason to believe that it is substantial. For example, in 1993 we reported that the California Student Aid Commission (CSAC), the

California state guaranty agency, had overstated its loans in repayment by about \$1.5 billion. As a result, CSAC received \$16.4 million in excess reinsurance payments in one year because it claimed more reinsurance payments than it was entitled to receive.

PEPS was designed and established several years ago to replace the Institutional Data System (IDS), which we reported in 1989 was inadequate. However, the Department has continued to operate two parallel systems, both of which are insufficient. Current work has shown that PEPS suffers from the same problems that plagued the IDS. To compensate, the Department has established additional subsystems, which not only creates additional expense but is inconsistent with the push for systems integration.

Technically Qualified Management and Staff -- The Department is at a critical juncture in information systems development and needs experienced senior management and personnel who have a high level of technical expertise. We are concerned about whether the Department is currently prepared to meet this challenge, particularly in light of fact that the position of Chief Information Officer recently became vacant. The Department's information resources management strategic plan was issued in draft in April 1996, prior to the appointment of the previous acting Chief Information Officer. Efforts were begun to update it under the previous acting Chief Information Officer, but have not yet been completed. The right decisions must be made now about systems design in order to have the systems necessary to run these financial programs effectively and efficiently and avoid unnecessary costs.

In our June 1996 Management Report concerning OPE, we reported that OPE had a shortage of qualified technical staff. We realize it is difficult to find highly qualified personnel with sufficient technical expertise in a very competitive job market where the Department is competing with the private sector (where such persons can command higher compensation) and other federal agencies. However, obtaining and maintaining this highly skilled staff is imperative if the Department is to be successful in running their financial programs.

To the Department's credit, it is attempting to upgrade its staff capabilities in the area of computer technology. In August 1996, the Department hired a new director of OPE's Program Systems Service who has extensive experience in information systems. However, the vacant Chief Information Officer position remains to be filled with an experienced information systems manager with the authority to ensure that future information technology investments are consistent with a rational, cost-effective, department-wide information and delivery systems architecture.

NSLDS Cost Overruns -- I have already noted the need for the Department to upgrade and integrate the NSLDS system. In attempting to do so, the Department has incurred significant cost overruns in the operation of the NSLDS, attributed by the Department to inaccurate estimates of usage costs. We will be addressing the issue in the near future and we will be paying particular attention to the contracting process for the recompetition of the NSLDS. We will look at the reasonableness of cost and the extent to which the system is integrated with the many other computer systems the Department uses for the SFA programs.

Preparation for Year 2000 -- GAO recently added the "Year 2000 Problem" to its list of government-wide high-risk issues. The two-digit format used by most computer systems to record dates will cause problems in the year 2000, because many computer systems will assume that the "00" date represents 1900 rather than 2000. The problem could result in erroneous data or system crashes throughout government. The Department has much work to accomplish in the next three years to ensure that its information systems will not be negatively impacted by this Year 2000 problem. The Department is in the process of identifying the systems that are susceptible to the problem and determining the steps to make the necessary corrections. Because this project is so vital to the Department's ability to function after the year 2000, my office will closely monitor its progress.

II. Management and Programmatic Issues

The Department's management of the SFA programs has commanded considerable scrutiny over the years from OIG, GAO and Congress. Most notably, the Senate Permanent Subcommittee on Investigations held a series of hearings from 1990 through 1995, highlighting fraud, waste, abuse and mismanagement in the SFA programs. Since 1988 the OIG has devoted the majority of our resources to the SFA programs, focusing on the management and programmatic issues that allowed the problems to continue.

The problems in the SFA programs have stemmed from the basic structural design of the programs and the lack of specificity in the authorizing statute, poor design and operations of the SFA delivery systems, and inadequate gatekeeping, monitoring and oversight of program participants. These longstanding management

and programmatic problems are the basis for the high-risk designation of the SFA programs by the GAO, with which I concur.

Management of the Two SFA Loan Programs -- In July 1994, the Department successfully phased in the new Federal Direct Loan Program (FDLP) in less than a year, a formidable challenge for any organization. In 1996, at the request of a Subcommittee of the House Economic and Educational Opportunities Committee (since renamed the House Education and the Workforce Committee), OIG completed a management review assessing whether the separate management structure established within OPE to launch and administer the FDLP separate from the FFELP was efficient.

We concluded that in order to implement the FDLP expeditiously, the Department acted reasonably by establishing a dedicated task force, which was successful in implementing the FDLP within the strict statutory timeframes. However, we also concluded that the manner in which the FDLP was implemented resulted in: inefficiencies; strained working relations; poor communication and cooperation; inappropriate alignment of functional units between FDLP and FFELP; and a delay in the development of the strategic plan for the SFA programs. As we recommended, the Department has reintegrated the loan programs' staffs.

Our review also identified a lack of qualified staff in the Program Systems Service which is responsible for the SFA contract administration. Given the amount of systems contracting involved in the administration of the SFA programs and the magnitude of current contracting activities, the absence of technically proficient staff in this area poses a significant risk to the Department. A Subcommittee of the House Committee on

Education and the Workforce has expressed concern about the Department's contracting process. I share their concerns and accordingly, have included in the OIG 1997-98 audit workplan several audits in this critical area.

The Need for Measurable Performance Standards -- I testified before this Subcommittee in June 1996 that OIG audits and investigations of non-degree-granting, vocational trade schools have demonstrated the inadequacy of accrediting agencies to assure the quality of training at those schools that participate in the SFA programs. Since I strongly believe that what you measure is what you get, I recommended to you that Congress legislate numerical, absolute and verifiable standards which those schools would have to meet in order to be eligible to participate in the SFA programs. Student outcomes are critical performance standards to measure the success of trade schools, and completion and job placements are the most important. The HEA itself defines such schools as institutions that prepare students for "gainful employment in a recognized occupation."

One OIG investigation revealed that at two related cosmetology schools in Chicago over a two-year period, it cost taxpayers approximately \$485,000 in SFA program funds for each of eight state cosmetology licenses, because so few students completed the program relative to the large numbers for whom the school received Pell Grants. Although this is not the norm, it is also not an isolated example. I submit that had there been performance standards for vocational trade schools that included completion and job placement, this waste of federal funds would in all likelihood not have occurred.

In response to an OIG audit report on accrediting agencies' shortcomings in developing and implementing student outcome standards, the Department has taken the position that performance standards

for schools need not necessarily be measurable and may serve only as goals and not as absolute bases for achieving or maintaining accreditation.

In addition, the Department rejected our recommendation to collect and compile performance data on institutions in the SFA programs from accrediting agencies. We strongly believe that these data are critical to measure the outcomes of the SFA programs and that the Department would significantly enhance its ability to comply with GPRA by collecting this information.

We continue to believe that accrediting agencies are inadequate gatekeepers for assuring the quality of participating vocational trade schools. A recent OIG audit of the accrediting agency process revealed that on-site reviews conducted by six accrediting agencies were infrequent, typically occurring only every 4 to 9 years, and lasted only several days. We believe more frequent on-site visits are necessary. We also recommended that the Department ensure that accrediting agencies are notified of serious deficiencies disclosed in program reviews, audits, and other oversight activities, to allow them to better target their high-risk reviews.

Congress has mandated completion and job placement performance standards before. With respect to short-term programs of less than 600 clock hours, a school must have a verified 70-percent completion and placement rates in order to continue to receive SFA program funds. Even this is a modest standard, because it requires that only 49 percent (less than one of every two) of students enrolled in vocational training get a job in the field for which they are trained. We believe that Congress should seriously consider a similar provision as a gatekeeping mechanism for all non-degree-granting, vocational schools in the upcoming HEA reauthorization.

Consolidation of Defaulted FFELP Loans Into the FDLP -- Last year we issued an audit report on the consolidation of defaulted loans held by the Department into the FDLP. We questioned the cost effectiveness of consolidating these defaulted loans, due to the up-front cost to consolidate (\$38 million for an estimated 80,000 defaulted borrowers), the loss of revenues under available collection methods, the unlikely prospect of sufficient payments under FDLP consolidation repayment options, and the likelihood of re-defaults. We also questioned why the Department would consolidate these loans under FDLP when they had available an income-contingent repayment option for defaulted FFELP loans held by the Department. We recommended that the Department stop actively pursuing such consolidations pending a study to demonstrate the cost effectiveness of the process. The Department agreed to the study.

Another potential issue relating to income contingent repayment is the potential for masking default rates of FFELP schools whose students take advantage of the opportunity to consolidate their defaulted FFELP loans into a new FDLP loan. Such a loan would not be counted as a defaulted loan for purposes of the school's cohort default rate under current regulations. We will be looking at this issue.

Reconciliation Process in the FDLP -- Over the last year, we have audited sixteen FDLP schools as part of our review of that new loan program. Overall, we did not find any material cash management problems in the FDLP at these schools. However, nine of the sixteen schools experienced problems with the reconciliation process. Reconciliation is extremely critical to ensuring that loan transactions reported by schools are accounted for completely and accurately. OIG has informed the Department of some of our concerns about FDLP reconciliation. Specifically, we suggested that the Department:

- ! reconcile specific advances with detail disbursement transactions and excess cash activity reported by the school, and
- ! provide adequate assurance that individual loan balances reflected in the Department's database are accurate.

We are aware that modifications will be made to the reconciliation process to provide the school with a student's net loan balance according to the Department's data each time any disbursements, adjustments or cancellations are reported on a loan. However, this process places complete reliance on the schools to determine whether loan balances reflected in the Department's database are identical to those on their internal student accounting records. This is insufficient to assure the accuracy of data in the Department's database.

Monitoring and Oversight of Schools -- In December 1993, we issued a performance audit report on the effectiveness of the Department's monitoring and oversight of institutions participating in the SFA programs. We recommended changes to the mission, structure, hiring and training practices; better targeting of reviews; establishment of performance standards; enhanced computer utilization; and establishment of reporting standards that together will increase the return on the Department's limited resources.

The Department has initiated a major effort to overhaul and redesign the institutional program review function, known as the "Institutional Participation and Oversight Service (IPOS) challenge." The Department's plans include a case management approach for its oversight of schools by both field and headquarters staff. A cornerstone of the effort is a risk analysis, still under development, to target schools for review. The risk model is scheduled to be pilot tested in April of this year. While we are supportive of this

effort, we have several concerns. First, as I noted above with regard to SFA program systems problems, the data from the information systems being used to determine which schools are high-risk is incomplete and in some cases inaccurate. Second, we question whether adequate resources are now being devoted to effective monitoring of schools while the IPOS challenge is in the development stage. We are concerned that IPOS has a number of other priorities that are competing with program reviews for the staff resources available. These include recertification of schools (discussed below) and tracking the independent audits submitted by schools. We will be evaluating the IPOS operations in the coming months.

Implementation of 1992 HEA Amendments -- As previously discussed, the HEA amendments provided the Department a number of new enforcement authorities to limit the participation of questionable schools in the SFA programs. These authorities include: the requirement that all schools be recertified within five years of the Act; provisional certification of marginal schools for up to three years; a 50-percent limitation on the percentage of ability-to-benefit students; and the "85/15 rule" which requires proprietary schools to obtain at least 15 percent of their revenue from non-Title IV sources.

Last year we reported that the Department could not complete all recertifications within the statutory timeframe, and that some schools were recertified that did not meet the standards for full certification. The Department has still not completed all the recertifications, but has enlisted the assistance of the field review staff. However, we still question the thoroughness of these recertifications, because as of June 1996, some schools that we believe should have been terminated were provisionally certified. Ongoing work also has shown the number of schools provisionally certified is rapidly increasing. Provisionally certified schools are

supposed to get a higher level of scrutiny from the Department. We question whether this is the case with the limited Departmental review resources.

We have also noted that the Department has provided inconsistent guidance for implementation of the "85/15 rule," and its monitoring system, consisting essentially of self reporting, is not adequate to assure that schools falling below the 15 percent level in non-Title IV revenues are removed. We also question the effectiveness of the Department's implementation of the 50 percent limit on ability-to-benefit students. The Department has been unable to provide us data on the number of schools that have been removed from the SFA programs as a result of these new requirements, and our own preliminary conclusion from ongoing work reflects that only a few schools have been removed from the programs based upon these new requirements. Since thousands of schools participate in the SFA programs, this appears to us to be unreasonably low.

Lessons Learned from Department's Financial Statement Audit -- The Department issued the Annual Accountability Report for Fiscal Year 1995 in September 1996. This marked the first year an independent audit was conducted of consolidated Department-wide financial statements. The Department prepared these consolidated statements one year earlier than required by the Government Management Reform Act 1994 (the successor to the CFO Act).

The results of the audit confirmed our previous work; many of the control weaknesses identified by the auditors related to the SFA programs, and they are discussed throughout this testimony. In summary, the auditors concluded that the loan-loss liability estimate reported in the Department's consolidated financial

statements for the FFELP could not be supported by sufficient and reliable accounting information. For this reason, the auditors were unable to express an opinion on the consolidated financial statements.

Government Performance and Results Act (GPRA) -- The Department has made good progress thus far in implementing the requirements of the GPRA. Indeed, the Department was ahead of schedule in producing its strategic plan, which is not due until September 1997. OIG was involved in the development of the first version of the strategic plan. The Department is currently in the process of revising the plan, and has a tracking system in place to measure its progress on implementing the plan.

The GPRA requires performance plans for each program administered by the Department, and the Department just recently submitted to the House and Senate Appropriations Committees draft performance plans for seventeen of its largest programs, including the SFA loan and grant programs. We are initiating a review of the Department's proposed indicators of performance.

I have already discussed OIG's recommendations concerning the need for statutory performance standards that are numerical and absolute as a gatekeeping mechanism for short-term trade schools that participate in the SFA programs. We believe this would be consistent with the principles of the GPRA. We are concerned that the Department has rejected our recommendation that it collect data from accrediting agencies on student outcomes, because we believe, as I have already discussed, that this is very important for GPRA purposes.

III. Areas of Fraud, Waste and Abuse

The third broad category I will address is fraud, waste and abuse issues relating to the SFA programs, and I will highlight some of the most important.

IRS Match -- Based upon our match of IRS tax returns with student loan applications for over two million students who were awarded Pell Grants, we found that for award year 1995-96, at least 102,000 students were over-awarded a total of approximately \$109 million in Pell Grants. These students failed to report or under-reported their income on the student aid application. On January 29, 1997, we issued our audit report recommending the Department be permitted to verify the income reported by students on the student aid application with the IRS.

Due Diligence Fraud by Lenders in Loan Servicing -- Current law and regulations require that lenders perform certain specified activities (known as "due diligence") in order to collect on federally insured loans as a prerequisite to being reimbursed by the guaranty agencies for defaults. The current system compensates lenders based upon their performance of due diligence activity, and not based upon their success in collecting. We have found a pattern of lenders who fail to conduct the mandated due diligence activities and then falsify documentation to reflect that they have met the due diligence requirements. In just two such cases, the fraudulent claims for reinsurance amounted to almost \$40 million. We believe that some other outcome-based method of compensation for lenders should be considered.

Failure To Pay Refunds -- Based primarily upon our on-going investigations, OIG continues to believe that failure on the part of schools to make required refunds of SFA program funds (both loans and grants) when students fail to enroll or withdraw to be a significant abuse in the SFA programs. It is also one that is very hard to fix at the back-end, because we have found it difficult to recoup money from school owners for their failure to pay refunds, and even when we do, it is difficult to obtain redress for victimized students. For example, in one California case, a federal jury recently found a former school owner guilty of a number of crimes in connection with his failure to pay at least \$6.3 million in refunds. However, we also found that he had no unencumbered assets to attach or seize, and students on whose behalf loan refunds were not made remain liable for those loans plus interest.

Administrative back-end fixes have also proved ineffective. If a school is terminated for failure to pay refunds, it has little or no incentive to pay past liabilities. The Department is limited in its ability to collect from corporate owners. We have also seen a number of instances where schools with refund liabilities were allowed to remain in the SFA programs based on a promise to repay over a long period of time and without interest; this almost invariably resulted in eventual closure of the school without the refunds being paid and additional students being victimized.

A related management problem is that the Department has no data on refund liabilities of schools. Therefore, we cannot quantify with any degree of certainty the magnitude of the problem, and the Department cannot take administrative action in a timely manner.

We have therefore recommended at every available opportunity since 1992 to the Department and to Congress in testimony (including before this Subcommittee in 1995) another more pro-active fix. School owners should be required to report and certify their refund liabilities on at least an annual basis so that the Department can identify schools that are delinquent and the extent of the liabilities. This would allow the Department to initiate timely corrective actions, and it would contribute important data to the risk analysis model under development in connection with the IPOS challenge described above. In addition, OIG would be able to use this certification for criminal or civil fraud prosecution purposes. We recently repeated the recommendation in a memorandum to the Assistant Secretary for Postsecondary Education and asked for an action plan; we have received no response. Accordingly, I plan to recommend again to Congress that the HEA be amended to include this requirement.

Screening for Prior Defaulters -- As a result of our 1992 audit report identifying weakness in the screening of student applications for SFA program funds, the Department implemented an edit check for prior defaulters which now matches the student data at the Central Processor with the NSLDS default data and flags for school financial aid administrators those applications by prior defaulters. We estimated that this edit procedure could save the Department and the taxpayers \$800,000 a day in ineligible funds being disbursed to previous defaulters.

However, these savings depend on the financial aid administrators taking appropriate action with respect to the flagged applications. Our preliminary results in an on-going audit reflect that some financial aid administrators are ignoring the default flag and awarding aid, thus circumventing the controls and making

ineligible awards. We will be performing additional audit work to determine the extent of the problem and make recommendations for corrective action.

Improper Claims by Guaranty Agencies -- We continue to find that guaranty agencies are retaining excessive amounts from payoffs on the consolidation of defaulted loans by improperly reporting the consolidations to the Department as collections on defaulted loans. Guaranty agencies are allowed to retain 18.5 percent on consolidations to cover their expenses, but are allowed to retain 27 percent on collections. We issued audit reports on six guaranty agencies that recommended the refund of over \$4 million of improperly retained funds.

We first identified this problem in 1994, and issued an SFA Action Memorandum to the Department in February 1994. We recommended that the Department issue guidance to the guaranty agencies to stop the incorrect reporting and retention of funds, and to identify and recoup the amount of excess consolidation loan payments retained by the guaranty agencies. The Department quickly responded by publishing guidance in March 1994, but it appears that some guaranty agencies have ignored the guidance, and the Department has not acted effectively to assure that the abuse is corrected.

Impact of Ability-to-Benefit Students on School Default Rates -- We long ago identified abuse in connection with the award of student aid to students without a high school diploma or GED certificate on the basis that they had the "ability to benefit" from the training offered. This is particularly true in the short-term

trade schools which typically have a large percentage of such students. In the 1992 HEA Reauthorization Act, Congress responded by placing a limit of 50 percent on a school's total enrollment of such students.

We recently completed a study on the relationship between the level of ability-to-benefit students and the student loan default and graduation rates for a sample of proprietary and vocational schools. The data demonstrate that schools that admit ability-to-benefit students place SFA program funds at a greater risk than schools that do not admit such students. We suggested that the Congress and the Department consider statutory changes to further reduce the number of ability-to-benefit students or eliminate them from eligibility for SFA program funds. We also suggested alternatives to safeguard the SFA program funds if the current 50-percent limit remains in place, such as limiting the amount of SFA program funds to schools that admit high percentages of ability-to-benefit students.

Professional Judgment -- We recently completed our audit field work on abuse of professional judgment by school financial aid administrators to override or change processed applicant data to determine the appropriate Pell Grant awards. We concluded that abuse of professional judgment at the 19 schools we reviewed resulted in at least \$775,000 in Pell Grant over-awards. In addition, an OIG investigation of a Maryland vocational trade school found evidence of widespread fraud consisting of false documentation of professional judgment decisions which resulted in inflated student aid awards of at least \$600,000. Our audit will recommend reforms to the statutory needs analysis process and more focused monitoring by the Department of schools at which the use of professional judgment exceeds the norm.

Pell Eligibility for High-Default Schools -- In the Appropriations Act for FY 1997, Congress included a prohibition on the participation in the Pell Grant program of those schools that were removed from the loan programs for high default rates. We are currently studying the impact of this provision, but based upon our experience with proprietary trade schools, we believe it is a good anti-fraud, waste, and abuse measure and should be incorporated into the HEA during the upcoming reauthorization so that it will have effect for more than one year at a time.

We have seen several costly cases where schools removed from the loan programs drove up their Pell Grant receipts by using fraudulent or abusive practices. For example, at the IADE schools in California, which were the subject of congressional hearings, the owners and financial aid director engaged in a scheme to retain Pell Grant monies for no-show students after losing their eligibility for loans. OIG's investigation recently resulted in an indictment of one of the owners and the financial aid director. IADE's owners and officers are alleged to have defrauded the government of over \$1 million for the period covered by the indictment.

Another OIG investigation in Chicago resulted in an indictment of owners of a beauty school chain which, after being restricted in its use of loans and ultimately being removed from participating in the loan program for high default rates, substantially increased its Pell receipts by aggressive recruitment tactics of unlikely cosmetology student, by substantially and arbitrarily increasing the up-front equipment charge, and drawing down and retaining Pell Grants for no-show students. For the two-year period covered by the indictment, it is alleged that the school owners defrauded the government of at least \$1.3 million.

This concludes my remarks. I will be happy to answer any questions you may have.