

**Statement of Thomas A. Carter
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**Before the
House Committee on Education and the Workforce
United States House of Representatives**

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Mr. Chairman and Members of the Committee:

Thank you for the opportunity to testify about the effectiveness and enforcement of Federal anti-fraud laws at for-profit (proprietary) institutions of higher education. As you asked, I will provide recent examples of fraud and abuse that my office has identified at proprietary institutions, and I will provide examples of fraud and abuse that we found at nonprofit and public institutions. I will also comment on how receptive institutions are to our recommendations and discuss collaborative efforts between my office and the Department of Education (Department) to address the risks of fraud and abuse.

First, I would like to take this opportunity to recognize the Department for its recent success. Since 1990, the student financial assistance programs have been included on the Governmental Accountability Office's high-risk list. Those programs were removed from the high-risk list in January 2005. However, as GAO cautioned when it removed these programs from its list, the Department must continue its progress and take additional steps to address remaining weaknesses in the administration of its programs. Because student financial assistance programs are complex and rely on numerous

participants, they are inherently risky and continued oversight will be needed to identify, assess, and manage risks of fraud and abuse.

Second, I want to continue to stress the need of Congress to enact an anti-fraud law, by amending the Internal Revenue Code, to allow the Department to match the information provided on student's applications with the income data that is maintained by the Internal Revenue Service (IRS). The Department currently estimates that \$365 million in Pell grants was improperly disbursed because applicants understated their income in fiscal year 2003.

This type of fraud is a long-standing problem, which we first estimated in 1997. The problems associated with applicants' understatement of income are not limited to the Pell program. This type of fraud may result in improper payments in student loan programs; create additional burdens for institutions, to verify applicant's income; and victimize unsuspecting students and parents who are advised by unscrupulous financial aid consultants to commit this type of fraud. A match of applicant income data with IRS data could also assist the Department in addressing a growing problem of identity theft, as I will discuss later in this statement.

I. Background on the Student Financial Assistance Programs

The Department's student financial assistance programs are large and complex. The loan and grant programs rely upon over 6,000 postsecondary institutions, more than 3,000 lenders, three dozen guaranty agencies, and a number of contractors and third-party

servers. Last year the Department disbursed and guaranteed approximately \$65 billion and managed a loan portfolio exceeding \$300 billion for these programs. The size and scope of the programs have increased greatly in recent years. The total program dollars has doubled in the last ten years alone. Increased variety in the delivery methods used to provide education to students (e.g., non-traditional terms or distance education), and virtually paperless electronic delivery of program funds, create new challenges to ensuring adequate oversight to identify, assess, and manage risks.

To address the purpose of this hearing, it is important to note that the requirements in the Higher Education Act of 1965, as amended (HEA), are the same for all types of institutions, except for two requirements. One of these requirements applies only to proprietary institutions, and the second applies to both proprietary and postsecondary vocational institutions.

A. Statutory Provisions for Participation in the Programs

The HEA provides criteria for an institution to be eligible to participate in student financial assistance programs and mandates the joint responsibility of a program integrity triad made up of state educational agencies, accrediting agencies, and the Department. This triad was created to ensure that institutions meet, and continue to meet, requirements for program participation:

- States provide licensing or other authorization necessary for an institution of higher education to operate within a state. A state is required to notify the Secretary whenever it revokes an institution's license or other authority to

operate, and must notify the Secretary whenever it has credible evidence that an institution has committed fraud in the administration of the student financial assistance programs.

- Accrediting agencies, recognized by the Secretary as reliable authorities on the quality of education or training offered, must establish, consistently apply, and enforce standards for eligible institutions. The standards are to ensure that the institution's courses, programs of training, or study (including distance education courses or programs) are of sufficient quality to achieve their stated objective. Within those standards, an agency must assess the institution's—
 - Success, with respect to student achievement and the institution's mission, based on course completion, state licensing exams, and job placement rates, as appropriate.
 - Measures of program length and the objectives of degrees or credentials the institution offers.
 - Compliance with its program responsibilities under the HEA, by reviewing the institution's most recent cohort default rate, financial or compliance audits, any program reviews, and any other information the Secretary provides to the agency.
- The Department assesses and certifies that an institution meets the HEA's eligibility criteria for administrative and financial responsibility. In making this determination, the Department relies on the approval of the applicable State and Accrediting agencies, annual independently audited financial statements, and compliance audits. Under the HEA, the Department must also conduct program

reviews, on a systemic basis, designed to include all institutions of higher education participating in the student financial assistance programs. The Department also may rely on—

- Audits and investigations performed by the Office of Inspector General (OIG), and
- Program reviews performed by guaranty agencies (for institutions participating in the Federal Family Education Loan (FFEL) Program only).

All institutions that participate in student financial assistance programs under the HEA must meet the eligibility, certification, and oversight provisions described above.

B. Additional Statutory Revenue Provision for the Proprietary Sector

The HEA provides an eligibility criterion that is unique to proprietary institutions of higher education. Known as the “90/10 rule,” the provision requires a proprietary institution to have—

- ... at least 10 percent of the institution’s revenues from sources that are not derived from funds provided under the student financial assistance programs, as determined in accordance with regulations prescribed by the Secretary.

Compliance with the “90/10 rule” must be calculated annually, based on the institution’s fiscal year. The institution must report the calculation as a footnote to the institution’s annual audited financial statements. The institution’s independent certified public accountant is expected to test the accuracy of the institution’s assertion as part of the audit of the financial statements.

C. Additional Statutory Provision for Training Programs

The HEA provides an eligibility criterion that is unique to proprietary institutions and postsecondary vocational institutions, programs of training. These institutions must—
... provide an eligible program of training to prepare students for gainful employment in a recognized occupation.

This requirement does not apply to nonprofit and public sector institutions' associate, bachelors, or postgraduate degree-granting programs.

II. Role of the OIG in Program Oversight

Under the Inspector General Act of 1978, the purpose of the OIG is to detect and prevent fraud, waste, and abuse, and to promote economy and efficiency in the Department's programs and operations. This testimony focuses on our efforts to detect and prevent fraud and abuse in the student financial assistance programs. We also discuss the adequacy of the Department's oversight of its programs.

Usually, we open investigations as a result of complaints or other credible evidence of risk of a potentially serious nature that may indicate fraud. Audits are generally initiated to assess specific areas of compliance, but may also be initiated as a result of complaints.

Historically, the majority of the OIG institutional audits and investigative cases have been in the proprietary sector. Over the last six completed fiscal years the majority—approximately 74 percent—of our institutional investigative cases involved proprietary

institutions. So far this fiscal year, we have opened 19 institutional investigative cases, 11 of which involve proprietary institutions.

Over the same period, we have issued 44 audit reports on proprietary institutions and 32 audit reports on nonprofit and public institutions. However, during the last three fiscal years, our office decided to conduct additional audits on nonprofit and public institutions, to assess potential risks in those sectors.

You asked me to address the reception by institutions to the recommendations in our audit reports or the results of our investigations. The short answer to this question is that institutions are rarely, if ever, receptive. Our audits usually recommend the return of funds or other administrative actions, and our investigations identify violations that usually result in criminal or civil proceedings.

The following two sections of my statement provide examples of fraud and abuse in the proprietary sector (Section III) and in the public and nonprofit sectors (Section IV). The examples I provide do not include all of the violations that our office has identified for each sector, nor are the examples for one sector necessarily unique.

III. Examples of Recent Fraud and Abuse in the Proprietary Sector

Proprietary institutions have been eligible to participate in the student financial assistance programs since 1972. This sector has evolved from being predominately vocational trade institutions, and now includes degree-granting institutions. Proprietary institutions have

also evolved into two classes of institutions: some are privately held and others are parts of much larger publicly traded corporations. Both are driven by profit and can also be driven by the need for growth. Over the years, we have come to identify a relationship between rapid growth and failure to maintain administrative capability. Several examples of recent fraud and abuse follow.

A. Refund Violations

Refund violations have been a longstanding problem in proprietary institutions. We continue to identify this problem in our audits and investigations. Refunds, which are referred to as “Return of Title IV Funds” under Section 484B of the HEA, are triggered when a student ceases to attend an institution. The institution must determine if refund is owed, calculate the amount of the unearned student financial aid funds, and it must return those funds to the Department, the FFEL loan holder, or to another applicable participant in the Title IV programs within a specified number of days. Violations of this requirement occur when refunds are not paid timely, when incorrect calculations result in returning insufficient funds, and when institutions fail to pay refunds at all. Failure to pay refunds is a criminal offense under the HEA. We have found all three types of refund violations in our audits, and these violations are the most frequent subject of our investigations.

B. Manipulation of the “90/10 Rule”- Ineligible Institution

Proprietary institutions must meet the “90/10 Rule” every fiscal year or they become ineligible to participate in Title IV programs. Since the institution itself performs this

calculation, it is not surprising that we have identified proprietary institutions that miscalculate or devise other creative accounting schemes (*e.g.*, fake institutional scholarship and loans) to make it appear they met this rule. When this occurs, ineligible institutions continue to participate in the Title IV programs.

C. Ineligible Students, Programs, and Locations

Our audits and investigations have identified schools that falsify student enrollment, attendance, high-school diplomas, GEDs, and ability-to-benefit exam results in order to qualify the students for student financial aid. Schools also improperly received student financial assistance funds because they failed to perform (or falsified) the verification required under the Department's regulations for selected students. We have found schools that enrolled students in programs that do not meet the minimum program eligibility requirement, and infrequently but consistently, we find institutional locations that do not meet basic eligibility requirements.

IV. Examples of Recent Abuses in the Public/Nonprofit Sectors

As I stated earlier, we have, over the last several years, devoted more resources to the nonprofit and public sectors. Following are three examples of fraud and abuse that we have found in those sectors.

A. Ineligible Institutions, Programs, and Students

We identified state postsecondary public institutions that were ineligible, because they were enrolling students under the age of compulsory high school attendance in the same programs as postsecondary students. We also recently issued audit reports that identified public institutions enrolling students in ineligible programs. Based on the course length, the programs were required to prepare students for employment in a recognized occupation, but the courses were not designed to do this. Our investigations have also identified ineligible students due to identification theft and other false information provided to public institutions.

B. Incentive Compensation Abuses

We issued a series of audits on nonprofit institutions where the schools had entered in into arrangements with an outside corporation, the terms of which violated the prohibition on the use of incentive compensation. Although the regulations governing this issue were amended subsequent to the audit reports, the corporation and institutions entered into settlement agreements with the Department.

C. Professional Judgment Abuses

Over the last several years, we have identified abuses in the use of professional judgment by financial aid administrators. Under the HEA, a financial aid administrator may make changes to an applicant's income and expense information so that the applicant may qualify for additional funding based on unusual circumstances. We found excessive use of this exception and failure to document the decisions as required by law.

V. Important Oversight Challenges

As we noted earlier, the student financial assistance programs are complex and have many participants, including lenders, schools, guaranty agencies, collection agencies, and financial aid consultants. Following are some examples where our work has documented the need for improved monitoring or other controls.

A. Inconsistent Monitoring and Oversight by the Department

We recently audited Federal Student Aid's (FSA) use of program reviews and technical assistance as a compliance tool, as well as its headquarters' management controls over regional offices' monitoring of postsecondary institutions. We identified the following significant weaknesses in FSA's oversight:

- Weaknesses in the regional office program review reporting process, retention of supporting documentation, and consistency in the review process placed FSA at risk of failing to adequately identify and report significant instances of noncompliance and of being inconsistent and inequitable in its conduct and resolution of program reviews.
- Problems with the regional offices' documentation of technical assistance and a lack of follow-up on the results of technical assistance prevented FSA management from having the ability to measure the effectiveness of technical assistance as a compliance tool.
- FSA headquarters did not 1) provide guidance for the selection of institutions for case management, 2) monitor regional offices' compliance with internal policies and procedures for program reviews and technical assistance, 3) evaluate the

effectiveness of program reviews or technical assistance conducted or the consistency of regional offices' selection of institutions for program review or technical assistance, or 4) evaluate the effectiveness of the enforcement actions taken as a result of regional office program reviews. This created the potential for inconsistent treatment of institutions across the country.

B. Accrediting Agencies Lack Meaningful Standards

In 2002 and 2003, we issued four reports on accrediting agencies, two on regional agencies and two on national agencies. Our objectives were to evaluate their standards for program length (the basis on which students receive student financial aid) and student achievement (a measure of what the Federal government is getting for the student aid it is investing in postsecondary education).

- Program Length
 - We found that neither regional agency had a definition of a credit hour that it required its institutions to follow. The standards these regional agencies applied to program length were vague and without definition, effectively allowing institutions to establish their own standards.
 - The two national agencies reviewed both had a definition of a credit hour in terms of the required hours of instruction needed to equate to a credit hour. One of them, however, did not include any requirement for outside preparation in its definition.

- Student Achievement
 - The regional agencies had not established minimum graduation, placement, and licensure rates for any of their institutions providing vocational education programs. For all education programs, these regional agencies permitted institutions to establish their own standards for student achievement, without any specified minimum standard.
 - The national agencies had established minimum graduation, placement, and state licensure rates for the institutions they accredited. However, at both we identified problems in the methodology by which the rates were calculated that caused the rates to be overstated.

C. State Agencies' Inconsistent Standards

Each postsecondary institution must be licensed to provide education by a state. The Department relies, in part, on the oversight of these state agencies to protect the students and the integrity of the programs offered by institutions within each state. We have found that state policies for licensing and evaluating institutions vary significantly. Some states have stringent processes for assessing education, while others may be limited to requiring a business license to operate. This variance in state oversight results in inconsistent monitoring at the state level.

D. Limitations of Cohort Default Rate

We issued an audit report in December 2003 in which we concluded that cohort default rates do not appear to provide decision makers with sufficient information about the rate

of default in the student assistance programs. To identify defaults, cohort default rates track the cohort of borrowers entering repayment in a fiscal year, through the following fiscal year. After the second fiscal year, subsequent defaults by the borrowers in the base-year cohort are not included in cohort default rate calculations. We found that cohort default rates appear to have been materially reduced by—

- A change to HEA’s definition of default, made by the Higher Education Amendments of 1998, from 180 days of delinquency to 270 days of delinquency. This 90-day delay excludes a significant number of defaulters from the cohort default rate calculation.
- An increase in the use of deferments and forbearances. We found that deferments and forbearances more than doubled from FY 1996 to FY 1999 (from 10.1 percent to 21.7 percent, respectively). A previous GAO report found that deferments and forbearances more than doubled from FY 1993 to FY 1996 (from 5.2 percent to 11.3 percent, respectively). Borrowers in deferment or forbearance do not make payments on their loans, so they cannot be counted as defaulters, but they continue to be counted with other students in the cohort. In effect, borrowers in deferments and forbearances reduce schools’ cohort default rates without establishing any intent to repay their loans.

To estimate the effect of these factors, we calculated an alternative/adjusted default rate that excluded borrowers in deferment or forbearance status and also included defaults we identified in the 90-day period following the two-year cohort period. For FY 1999, the reported cohort default rate was 5.7 percent. Our adjusted default rate for that period was 8.4 percent.

E. The Department Needs Authority to Implement the IRS Income Match

As I noted earlier, since 1997, we have recommended implementation of an IRS income data match. The Department has been working with the Office of Management and Budget and the Congress for additional authorizing legislation. While the HEA has been amended to permit this match, a corresponding amendment to the Internal Revenue Code has not been enacted.

In the meanwhile, the estimate of Pell grants disbursed based upon understated income figures from the applicants is growing, from our \$177 million estimate for award year 1995-96, to the Department's current \$365 million estimate for fiscal year 2003. We urge Congress to enact this control necessary to address fraud and abuse by both applicants and institutions.

F. Identity Theft Fraud by Ineligible Students

Identity theft typically occurs on the application for student financial aid when a person intentionally uses someone else's name, Social Security number, and date of birth to fraudulently obtain student aid. People who obtain loans through identity theft almost always default on those loans.

We have experienced an increase of identity theft cases in recent years. Several of our most successful investigative cases have resulted from referrals by alert institutional financial aid administrators, and, as I describe below, we are working to make all participants in the student financial aid programs aware of this growing problem. The

income data match I discussed above could help prevent fraud through identity theft in those situations where the applicant has the identifying information of someone else, but lacks the potential victim's income information.

VI. Our Ongoing Efforts to Reduce Fraud, and Abuse

A. OIG/FSA Joint Fraud Project

Based upon our work, we conducted an analysis of patterns of fraud and abuse in the student financial aid programs. We supplied this analysis, and suggestions for preventive measures, to the Department in March 2003. Based on our continued concerns with fraud and abuse in the programs, and with the Department's estimates of erroneous payments under the Improper Payment Act of 2002 (consisting primarily of overpayments in the Federal Pell Grant program due to applicant income information), we planned a proactive effort to identify fraud and abuse.

Together with FSA, in December 2004, we initiated a joint project to discover and prevent fraud in the student financial aid programs. We have identified risk categories and the following three categories as areas of high risk: 1) application falsification, 2) identity theft, and 3) school risk factors. We have established three working groups, comprising a mix of OIG and FSA personnel with audit, investigative, inspection, program, and system/data knowledge. Each group is drafting plans to perform risk assessments and to research existing data from external sources and from internal sources through the use of

data mining techniques. Later this year, other work groups will address risk factors specific to the student loan programs.

B. Identity Theft Outreach

With FSA, we developed and continue a campaign to alert students to the threat of identity theft by updating our website, www.ed.gov/misused, which contains information about preventing and reporting identity theft involving federal education dollars, as well as information concerning recent scams against the student financial aid programs. We also sent information about how to prevent identity theft to guaranty agencies and to over a thousand campus security websites and college newspapers. With the assistance of the Arizona Department of Public Safety, we produced a DVD, “FSA Identity Theft: We Need Your Help,” featuring an individual incarcerated for student aid fraud who describes the techniques he used to steal identities. We are using this DVD in our continuing outreach campaign and have provided copies to FSA and individuals in the IG community. We have written identity theft articles for various publications including the International Chiefs of Police magazine, the *FBI Bulletin* and the Federal Law Enforcement Officer’s Association *1811 Newsletter*. We continue to raise this issue with all participants in the student financial aid programs at every opportunity.

C. Data Mining Efforts

We have recently established a cyber group in our office that will have enhanced technical capacity and access to Department data systems. Working with our analysts, that group will assess the data maintained in the various Department and contractor

systems in order to identify potential fraud schemes or patterns that can be addressed in a systematic way. We plan to develop standard parameters that will allow us to search, identify and analyze data for targeting areas of fraud for investigation and to improve the Department's programs.

D. OIG HEA Reauthorization Proposals

In January 2004, we submitted to this Committee 20 recommendations for changes we believe are needed in the reauthorization of the Higher Education Act. These recommendations are supported by our audit, inspection, and investigative work in the student financial aid programs. We urge you to consider each of the suggestions.

Several of the most significant are

- Increase the validity of cohort default rates,
- Provide a statutory definition of a credit hour,
- Require accrediting agencies to have quantitative standards, and
- Make persons convicted of Title IV fraud no longer eligible to receive student financial aid.

Implementation of these suggestions would increase accountability in postsecondary education and the student financial assistance programs, provide additional oversight tools for identifying risks, and assist in reducing fraud and abuse in the programs.

We will continue to assist the Department in its efforts to identify and reduce fraud and abuse, to safeguard student financial assistance dollars, and to help ensure that these funds reach the intended recipients.

This concludes my written statement. I would be happy to answer your questions.