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U.S. Department of Education
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Committee on Health, Education, Labor, and Pensions
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Chairman Harkin, Ranking Member Enzi and Members of the Committee:

Thank you for inviting me here today to discuss the U.S. Department of Education (Department) Office of Inspector General's work involving for-profit postsecondary institutions, referred to herein as proprietary institutions. This is my first opportunity to testify before this Committee since it approved my nomination as the Inspector General earlier this year. It is an honor to have received your support to lead this organization, and I look forward to working with you to improve Federal education programs and operations so they meet the needs of America's students and families.

Before I begin my testimony, I would like to take this opportunity to recognize the Department for the release of its Notice of Proposed Rulemaking last week. I would also like to acknowledge the higher education community, whose discussions with the Department throughout the 2009-2010 negotiated rulemaking sessions contributed to the development of the Department's proposed rules—a number of which address program integrity issues related to proprietary institutions that I will talk about today. We will

comment on the proposed rules and monitor the implementation of the final rules, and do what we can to ensure that they assist in protecting our nation's students, parents and taxpayers.

I would also like to take a moment to address the significant change coming to the Federal student aid programs on July 1, 2010. The *Health Care and Education Reconciliation Act of 2010*, Public Law 111-152, mandated there will be no new Federal Family Education Loan (FFEL) originations as of July 1, 2010. As a result, in a very short period of time, the Department must assist schools in transitioning to process all new loans under the William D. Ford Direct Loan program (Direct Loan), oversee the wind down of the FFEL program and its billions in Federal assets and improve its oversight of additional contractors, while managing the risks presented by postsecondary institutions and the vulnerabilities that exist with distance education. Ensuring that the Department's infrastructure, processes, oversight, and monitoring are effectively operating in order to guarantee that every eligible American student receives the aid to which he or she is entitled is of vital concern to this Committee as well as to my office and will continue to be a major focus of our efforts.

Background on the OIG and Federal Student Aid Programs

As members of this Committee know, the Federal student aid programs have long been a major focus of our audit, inspection, and investigative work, as they have been considered highly susceptible to fraud and abuse. The programs are large, complex, and inherently risky due to their design, reliance on numerous entities, and the nature of the

student population. The Department provided \$129 billion in aid to students and parents during fiscal year (FY) 2009 and has an outstanding student loan portfolio of more than \$600 billion.

OIG has produced volumes of significant work involving the Federal student aid programs, leading to statutory changes to the *Higher Education Act of 1965*, as amended (HEA), as well as regulatory and Departmental changes. This includes extensive work involving proprietary institutions. According to the Department, Federal student aid funding for proprietary institutions has grown by 109.4 percent from 2004-2005 to 2008-2009, while funding for public and non-profit institutions grew by approximately 40 percent for the same time period.

The HEA provides eligibility criteria that an institution must meet in order to participate in the Federal student aid programs. State educational agencies, accrediting agencies, and the Department all have responsibility for program integrity to ensure that institutions meet, and continue to meet, requirements for participation in the Federal student aid programs. For example:

- States provide licensing or other authorization necessary for an institution of higher education to operate within a state;

- Accrediting agencies, recognized by the Secretary of Education (Secretary) as reliable authorities on the quality of education or training offered, must establish, consistently apply, and enforce standards for eligibility; and
- The Department assesses and certifies that an institution meets the HEA's eligibility criteria for administrative and financial responsibility. It must also conduct program reviews, on a systemic basis, designed to include all institutions of higher education participating in the Federal student aid programs.

Institutional eligibility, certification, and oversight requirements in the HEA are the same for all types of postsecondary 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.

Statutory Revenue Provision for the Proprietary Sector

The HEA provides a 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 Higher Education Opportunity Act of 2008*

changed the 90/10 Rule from an institution eligibility criterion to a condition of program participation, and provided additional resources to be included as institutional revenue. These amendments were a significant change that made it easier for institutions to meet the 90/10 Rule, and institutions that fail to comply with the Rule are now allowed to continue participation in the Federal student programs for two years while they attempt to meet the Rule. 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.

Statutory Provision for Training Programs

The HEA provides an eligibility criterion that is unique to proprietary institutions and postsecondary vocational institutions regarding 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.

Role of the OIG in Program Oversight

In 2005, OIG testified before Congress on the topic of waste, fraud, and abuse in the proprietary sector. At that time, we reported that, historically, the majority of our

postsecondary institutional audits and investigations involved proprietary schools. More than five years later, this continues to be the case.

OIG generally opens an investigation as a result of credible evidence developed from complaints and other sources that may indicate fraud. Audits or inspections are generally initiated to assess specific areas of compliance but may also be initiated as the result of a complaint. Since our 2005 testimony, OIG has issued 37 reports on postsecondary institutions, 21 of which involved proprietary schools. In 2005, we reported that looking at the previous 6 years of data, 74 percent of our postsecondary institutional investigations involved proprietary institutions. Today, that number is very similar—70 percent of our current investigations involving postsecondary institutions are proprietary school related.

Fraud and Abuse in the Proprietary Sector

Proprietary institutions have been eligible to participate in the Federal student aid 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. The volume of Federal student aid dollars going to the publicly traded sector has seen tremendous growth in recent years. Over the years, we have come to identify a relationship between rapid growth and failure to maintain

administrative capability. The following are several examples of the types of fraud and abuse our work has identified involving proprietary institutions.

Falsification of Eligibility

Our audits and investigations have identified proprietary schools that falsify student enrollment, attendance, high-school diplomas, General Educational Development certificates, ability-to-benefit exam results, and satisfactory academic progress in order to qualify the students to obtain or continue to maintain Federal student aid. Schools also improperly received Federal student aid funds because they failed to perform or falsified the verification required under the Department's regulations for students. We have found schools that enrolled students in programs that do not meet the minimum program eligibility requirement and institutional locations that do not meet basic eligibility requirements.

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 the HEA, are triggered when a student ceases to attend an institution. The institution must determine if a refund is owed, calculate the amount of the unearned Federal student aid, and then return those funds to the Department, the FFEL loan holder, or to another applicable participant in Federal student aid programs within a specified number of days. Violations of this requirement occur when refunds are not timely paid,

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 frequent subject of our investigations.

90/10 Rule

Defined previously in this testimony, proprietary institutions must meet the 90/10 Rule every fiscal year to continue participation in Federal student aid programs. We have identified proprietary institutions that miscalculate or devise other creative accounting schemes (*e.g.*, fake institutional scholarships and loans) to make it appear they met this rule. When this occurs, ineligible institutions have continued to participate in the Federal student aid programs.

Incentive Compensation

We receive and review complaints of aggressive recruiting and violations of the HEA's ban on incentive compensation by proprietary institutions. We have reviewed compensation plans that are clearly providing direct financial incentives for recruiters to increase enrollment. However, due to the safe harbors included in the Department's current regulations, in many cases, schools are shielded from administrative, civil, and criminal liability. Proprietary institutions are making full use of the safe harbors in the Department's regulations to provide financial incentives to drive enrollment. In 2002, when the Department originally promulgated the safe harbor rules, we advised the Department that provisions of

those regulations were contrary to the requirements of the HEA and reported our disagreement to Congress. In its Notice of Proposed Rulemaking issued last week, the Department proposes to eliminate all safe harbors and return to the clear ban on incentive compensation stated in the HEA. This is a significant step to eliminate aggressive recruiting practices.

Distance Education

Distance education—both at proprietary and non-profit institutions—is an area that is placing increased demands on our investigative and audit resources and highlights the need for greater oversight and statutory or regulatory change. The issue is determining whether students in distance education are “regular students” as defined by the HEA, and actually in attendance for Federal student aid purposes. Institutions are obligated to return any Federal student aid received if a student does not begin attendance during the period for which aid was awarded. Institutions must be able to document attendance in at least one class during a payment period. Determining what constitutes a class and class attendance in the on-line environment is a challenge in the absence of defined class times or delivery of instruction by instructors. On-line instruction typically consists of posted reading materials and assignments, chat-room and email exchanges, and posting of completed student work. The point at which a student progresses from on-line registration to actual on-line academic engagement or class attendance is often not defined by institutions and is not defined by Federal statute or regulations. Without such definition, or adequate controls at the institutions

themselves, we believe Federal student aid funds are at significant risk of being disbursed to ineligible students in on-line programs, and that inadequate refunds will be made for students who cease attendance in these programs.

Evolving Oversight Challenges

As we noted earlier, the Federal student aid programs are complex and inherently present risk. Following are several examples of what we consider evolving oversight challenges that impact both proprietary and non-profit institutions.

Accrediting Agencies Lack Meaningful Standards for Program Length

In 2009 and 2010, we evaluated regional accrediting agency standards for program length and the definition of a credit hour. We examined three of the seven regional accrediting agencies to determine what guidance regarding program length and credit hours they provided to institutions and peer reviewers, and the documentation they maintained to demonstrate how they evaluated institutions' program length and credit hours. The three accrediting agencies reviewed represent one-third of the institutions participating in Federal student aid programs: 2,222 postsecondary institutions with more than \$60 billion in Federal student aid funding. We found that none of the accrediting agencies defined a credit hour and none of the accrediting agencies provided guidance on the minimum requirements for the assignment of credit hours. At two of the accrediting agencies, we were told that student learning outcomes were more important than the assignment of credit hours; however, these two accrediting

agencies provided no guidance to institutions or peer reviewers on acceptable minimum student learning outcomes at the postsecondary level.

While conducting our inspection at one of the agencies, we identified a serious issue that we brought to the Department's attention through an Alert Memorandum: the Higher Learning Commission of the North Central Association of Colleges and Schools (HLC) evaluated American InterContinental University (AIU)—a proprietary institution owned by Career Education Corporation (CEC)—for initial accreditation and identified issues related to the school's assignment of credit hours to certain undergraduate and graduate programs. HLC found the school to have an "egregious" credit policy that was not in the best interest of students, but nonetheless accredited AIU. HLC's accreditation of AIU calls into question whether it is a reliable authority regarding the quality of education or training provided by the institution. Since HLC determined that the practices at AIU meet its standards for quality, without limitation, the Department should be concerned about the quality of education or training at other institutions accredited by HLC. Based on this finding, our Alert Memorandum recommended that the Department determine whether HLC is in compliance with the regulatory requirements for accrediting agencies and, if not, take appropriate action under the regulations to limit, suspend, or terminate HLC's recognition by the Secretary. The Department initiated a review of HLC and determined that the issue identified was not an isolated incident. As a result, the Department gave HLC two options for coming into compliance: (1) to accept a set of corrective actions

determined by the Department; or (2) the Department would initiate a limitation, suspension, or termination action. In May 2010, HLC accepted the Department's corrective action plan.

In addition, in its Notice of Proposed Rulemaking issued last week, the Department proposed a definition of a credit hour and procedures for accrediting agencies to determine whether an institution's assignment of a credit hour is acceptable.

Borrower Defaults

Considering the economic downturn over the last several years, combined with escalating student loan debts, a significant concern is the potential for increased loan defaults as we have seen the national cohort default rate increase recently. As an example, last year, the Department announced that the FY 2007 national student loan cohort default rate increased to 6.7 percent, up from the FY 2006 rate of 5.2 percent. The 2007 cohort default rate for schools participating in the FFEL Program was 7.2 percent, a 36 percent increase over the 2006 rate of 5.3 percent. The 2007 cohort default rate for schools participating in the Direct Loan Program was 4.8 percent, a 2 percent increase over the 2006 rate of 4.7 percent. The FFEL portfolio has a larger percentage of proprietary schools, which have higher default rates, and a lower percentage of public and private 4-year schools, which have lower default rates. FY 2007 national cohort default rate was 6.7 percent, while the proprietary school default rate was 11 percent.

In a 2003 audit report 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. Currently, 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. While the *Higher Education Opportunity Act of 2008* changed this calculation to track borrowers over three years, this change will still not adequately reflect all defaults.

Not addressed by this change were two issues noted in our earlier report. In that report, we identified that cohort default rates were not a true representation, as they were reduced by: (1) a statutory change to the HEA's definition of default 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; and (2) an increase in the use of deferments and forbearances.

Deferment entitles a borrower to have periodic installment payments of principal deferred during authorized periods; forbearance permits the temporary cessation of payments. We found that deferments and forbearances had more than doubled in the period we examined. Borrowers in deferment or forbearance do not make payments on their loans, so they are not counted as defaulters, but they continue to be counted with other students in the cohort, thus reducing the cohort rate.

While we recognize that the Congress has provided additional repayment

flexibilities, when borrowers reach the limits on deferments and begin repayment they may still lack the income and eventually default and are not accounted for in the cohort default rate.

Estimating future loan defaults is a very difficult process. As part of the requirements related to the *Federal Credit Reform Act of 1990*, as amended, the Department must annually estimate loan volumes and the attendant costs, and in doing so, factor in economic conditions. Our financial statement auditor has raised concerns about the Department's estimation process, including its failure to take into account recessionary conditions, and has made a number of recommendations for improvements. The Department's credit reform estimates continue to be reported in our audit of the financial statements as a significant internal control deficiency.

Direct Loan Program

Guaranty agencies have always had a responsibility to enforce the requirements for school participation in the FFEL program and have served as an important source of possible waste, fraud, or abuse referrals for our office. As guaranty agencies move away from guaranteeing and performing oversight of loans for currently enrolled students, they will no longer serve as a source of oversight and information on school participation in the loan programs.

In the transition to the Direct Loan program, the Department will have to itself perform the school loan oversight function previously performed by guaranty agencies. Loan origination and servicing functions previously performed by lenders and guaranty agencies in the FFEL program are now the responsibility of the Department. The Department relies on contractors to perform these functions in the Direct Loan program. The Department had to modify its loan origination system, assure all institutions are capable of using the system, and contract with four new loan servicers last year to service the loans it purchased from lenders and handle the increased volume in the Direct Loan program.

Because the Direct Loan program will become the largest lending program within the Federal government, we are examining the applicability of Federal banking statutes to determine if similar statutory provisions for enhanced program integrity should be recommended for the Department, as they have been for other Federal lending programs.

OIG Recommendations for Strengthening Laws/Regulations

In your invitation for me to testify today, you asked me provide an assessment of whether current laws are sufficient to protect students and taxpayers. Congress could address two areas that would increase accountability in postsecondary education and the Federal student aid programs, as well as provide additional oversight tools and assist in reducing fraud and abuse in the programs: amending the Internal Revenue Code to permit an Internal Revenue Service (IRS) income match for student loan applicants and reconsider the cost of attendance for individuals engaged in on-line education courses.

IRS Match

Since 1997, we have recommended implementation of an IRS income data match, which would allow the Department to match the information provided on student's application for Federal student aid with the income data that is maintained by the IRS. While the HEA has been amended to permit this match, a corresponding amendment to the Internal Revenue Code has not been enacted. This action would go a very long way to identifying income inconsistencies and eliminating an area of fraud and abuse within the student financial assistance programs.

While the Department began a pilot project this January to allow applicants the choice to have the Department obtain income data directly from the IRS, we do not believe it likely that those individuals intent on defrauding the program by providing false income information would select the IRS option. Leaving this area unaddressed creates additional burdens for institutions to verify an applicant's income and victimizes unsuspecting students and parents who are advised by unscrupulous financial aid consultants to commit this type of fraud. Our investigations have found that some officials at proprietary institutions have encouraged students to falsify their income and dependents to qualify for Federal student aid.

Cost of Attendance Calculations for Distance Education Programs

Since 2001, OIG has recommended that the HEA be amended to address cost of attendance (COA) calculations for on-line learners. Currently, students in on-line programs and residential programs can be eligible for the same amount of Federal student aid based on the same COA. The COA as defined by the HEA primarily includes:

- Tuition and fees normally assessed a student, including the costs for rental or purchase of any equipment, materials, or supplies;
- An allowance for books, supplies, transportation, and reasonable miscellaneous personal expenses, including a reasonable allowance for the documented rental or purchase of a personal computer;
- An allowance for room and board costs incurred by the student which shall be an allowance for (a) students without dependents residing at home with parents, (b) students without dependents residing in institutionally owned or operated housing, and (c) for all other students an allowance based on the expense reasonably incurred for room and board; and
- An allowance for dependent care for students with dependents.

The HEA limits the COA for students engaged in correspondence courses to tuition and fees, and, if required, books, supplies, and travel. There is no similar

limitation for on-line students. With the explosion of on-line education in recent years and the number of full-time working individuals that take these courses, a COA budget that includes an allowance for room and board for on-line learners may not be in the best interest of American taxpayers and may allow students to borrow more than is needed. We also note that under the Post-9/11 GI Bill, Congress has already determined that active duty personnel and veterans enrolled exclusively in on-line programs should receive reimbursement only for tuition and fees and not receive a housing allowance. Congress should reconsider the COA calculation for distance education programs under the HEA, which could reduce loan borrowing, decrease loan debt, and reduce the amount of funds available above tuition and thus obtainable by individuals who seek to defraud the Federal student aid programs through on-line fraud schemes.

Closing Remarks

In closing, I would like to once again mention the Department's recently proposed regulations governing the Federal student aid programs, many of which we have previously identified and recommended to the Department through our audit, inspection, and investigative work. The Department has proposed a definition of a credit hour and changes to the rules governing incentive compensation by eliminating regulatory safe harbors. Other changes proposed include improvements to the rules (1) protecting students from misrepresentation, (2) governing ability-to-benefit testing and satisfactory academic progress, and (3) establishing a process to check whether a high school diploma is valid for student eligibility purposes. Again, we will comment on the proposed rules

and monitor the implementation of the final rules. We believe changes in all these areas will improve protections for students and taxpayers. In the meantime, let me reiterate that OIG is committed to promoting accountability, efficiency, and effectiveness in all Federal education operations and programs. We will continue to assist the Department in its efforts to identify and reduce fraud and abuse, to safeguard Federal student aid dollars, and to help ensure that these funds reach the intended recipients.

On behalf of the OIG, I want to thank you for the support this Committee has given to this office over the years. We look forward to continuing to work with Congress in furthering our goals and achieving our mission.

This concludes my written statement. I am happy to answer any of your questions.