

**Statement of John P. Higgins, Jr.
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**Before the
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United States House of Representatives**

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Chairman Davis and members of the Committee, I would like to thank you for the opportunity to testify today about the management and performance of the Federal Family Education Loan Program (FFEL) and the William D. Ford Federal Direct Loan Program (Direct Loan), within the U.S. Department of Education (Department). As you requested, I will provide information on the high-risk areas in the federal student loan programs identified through our on-going fraud initiative that we have undertaken with the Department's Office of Federal Student Aid (FSA). I will also discuss our related Work Plans for fiscal years 2005 and 2006, as well as touch upon legislative changes that, based on our work and findings, are needed to improve the management of these programs.

For 25 years, the Office of Inspector General (OIG) has worked to promote the efficiency, effectiveness, and integrity of the Department's programs and operations. We conduct independent and objective audits, investigations, inspections, and based on our findings, make recommendations to the Department. Our staff of about 290 includes financial, information technology and program auditors, criminal investigators, inspectors, computer intrusion experts, management and budget analysts, and attorneys. We have staff in 14 locations, including Puerto Rico and the Virgin Islands. As the Department's budget and responsibilities have grown, we have continued our commitment to identify and help the Department combat waste, fraud and abuse in its programs and services. We have increased our efforts to identify emerging threats to the integrity of the Department's programs, such as identify theft and information security, and together with the Department, are creating new mechanisms to improve our work in finding and helping to reduce fraud and abuse in the federal student loan programs.

I. Background on the Student Loan Programs

The Department's student loan programs are large, complex, and inherently risky due to their design, reliance on numerous entities, and the nature of the borrower population. The loan programs rely upon over 6,000 postsecondary institutions, more than 3,000 lenders, 35 guaranty agencies, and many contractors to assist in the administration of the programs. Last year, the Department disbursed and guaranteed approximately \$50 billion in new loans, and managed a loan portfolio approaching \$400 billion for these programs.

In 1990, the Government Accountability Office (GAO) placed the student financial assistance programs on its high-risk list. The Department responded by developing plans and continually working to improve its financial management and internal controls, integrating information systems, and creating a balanced management approach to minimize noncompliance sufficient to satisfy GAO. GAO removed the program from its high-risk list in January of this year, but cautioned, as it did so, that the Department must continue its progress and take additional steps to address remaining weaknesses in the administration of its programs.

Effective oversight is important with the increased variety of delivery methods used to provide education to students, (*i.e.*, non-traditional terms and distance education) together with the virtually paperless electronic delivery of program funds. These developments create new challenges to ensuring adequate oversight to identify, assess, and manage the risks in these programs.

II. OIG/FSA Fraud Initiative

In late 2003, we conducted an analysis of patterns of fraud, and abuse in student financial assistance programs. We completed this analysis and developed suggestions for preventive measures, and provided them to the FSA. In 2004, my office drafted a plan to estimate the amount of fraud in the loan programs. Prior to beginning the effort, I asked Terri Shaw, Chief Operating Officer of FSA if she and her staff were interested in making this a joint project. She was interested and, following some discussion on how to proceed, we decided to combine our expertise and develop a proactive approach to identifying and reducing fraud and abuse in these programs, as well as addressing related management issues. Thus, the OIG/FSA Fraud Initiative was launched in December 2004.

This collaborative effort brings together OIG and FSA personnel with extensive audit, investigative, inspection, program, and systems/data knowledge. For the purposes of this project, the team defined fraud as the “intentional effort to unlawfully obtain student financial assistance funds or benefits that a person is not entitled to,” and we defined abuse as “non-compliance with statutory and regulatory requirements or obtaining more student financial assistance funds than entitled.”

Our initial strategy session covered the life cycles of the programs, from the students’ or parents’ application for aid through the repayment/discharge of their loan obligations. We discussed known fraud and abuse areas within the student financial assistance programs, existing weaknesses in program control, as well as potential and emerging areas of vulnerability. Based on the expertise of the group’s participants, 11 high-risk categories were identified: Free Application for Federal Student Aid (FAFSA) falsification, identity theft, fraud and abuse at schools, E- Signature/Personal Identification Number (PIN), distance education, lender fraud and abuse, guaranty agency abuse, loan discharges, loan consolidations, monitoring contracts in the Direct Loan program, and risks specific to the Perkins Loan Program.

The group selected three key issues to focus on during the first phase of the project: 1) FAFSA falsification, 2) identity theft, and 3) fraud and abuse by schools. These categories were selected as they begin the student financial assistance process, and all have been the subject of frequent OIG audits and investigations. Subsequent categories will be analyzed later this year.

In February 2005, the OIG/FSA Fraud Initiative team established three working groups, comprised of six to eight OIG and FSA personnel, to focus on the first three risk categories. The teams are meeting throughout the year to gain a thorough understanding of each issue, process, and existing management controls, or controls circumvented. They are developing profiles of known fraud and abuse to identify patterns, research existing data from internal sources through the use of data mining techniques, and consider information from external sources. Based on their findings, they will produce work plans with timelines and milestones for effectively addressing these issues.

Consistent with the focus of the hearing, the information and examples that I provide below center on the risks in the FFEL and Direct Loan programs, and omit any discussion of the Perkins Loan program. While OIG and FSA jointly selected these risk areas, I will illustrate them with examples of the work performed by OIG only.

FAFSA Falsification

False information on the FAFSA, particularly underreporting income, continues to be a significant problem in the student financial assistance programs, and often results in the individuals receiving student financial assistance to which they would not otherwise be entitled. Information contained in the FAFSA, the document that begins the process for an applicant to receive student financial assistance, determines an individual's initial eligibility. Questions on the FAFSA include citizenship, educational level, filing status (*i.e.*, dependent or independent), income, assets, and number in household in postsecondary education. This information is used to determine basic eligibility through a series of data matches with other systems, and statutory formulas are used to compute the Expected Family Contribution (EFC). The EFC is critical in calculating the amount of student aid the applicant is eligible to receive.

Underreporting income on the FAFSA impacts eligibility for student loan programs, as income is a critical factor in determining whether the student is eligible for a subsidized or an unsubsidized loan. Underreporting of income also consumes valuable institutional resources to attempt to verify applicant income, and can victimize unsuspecting students and parents through the actions of unscrupulous financial aid consultants seeking personal financial gain. The Department has not estimated the effect of misreporting of income on the student loan programs. However, to demonstrate the impact of misreporting income, it has estimated that \$365 million in Pell grants were over-awarded because applicants understated their income in fiscal year 2003. OIG first estimated over-awarding of Pell Grants due to underreported income in 1997. At that time, our estimate was \$177 million for award year 1995-96.

Congress can immediately correct this problem, and help the Department better identify potential FAFSA income falsification, by amending the Internal Revenue Code to allow the Department to match the information provided on FAFSAs with the income data that is maintained by the Internal Revenue Service. While the Higher Education Act (HEA) has been amended to permit this match, a corresponding amendment to the Internal Revenue Code has not been enacted. The Department has been working with the Office of Management and Budget (OMB) and the Congress for additional authorizing legislation.

My office continues to investigate cases of students and parents providing false income and other information on the FAFSA to obtain student financial assistance for which they are not entitled. We also investigate financial aid consultants advising individuals to provide false information on the FAFSA. For example, a joint OIG/U.S. Postal Inspection Service investigation led to the conviction and sentence of an individual whose actions resulted in an estimated loss to the government of over \$1 million, with a potential loss in grants and loans totaling over \$10.7 million. The individual held seminars at churches and universities, instructing and assisting individuals in preparing and submitting FAFSAs that falsely identified them as “orphan/ward of the court,” indicated dependency upon a single parent or grandparent, or quantified household income. The investigation disclosed that the individual met with approximately 400 students per year and charged the families between \$250-\$350 for his assistance. The individual was sentenced to 41 months incarceration, followed by five years supervised release, and was ordered to pay over \$716,000 in restitution

Identity Theft

Identity theft is one of the fastest growing crimes against consumers and poses a risk in the student financial assistance arena. Identity theft typically occurs on the FAFSA when a person intentionally uses someone else’s name, Social Security number and/or date of birth (DOB) to fraudulently obtain student financial assistance. People who obtain loans through identity theft almost always default on those loans.

Our OIG investigators continue to aggressively pursue individuals who steal by misusing the identity of others. For example, our office recently conducted an identity theft investigation in Cedar Rapids, Iowa that involved a conspiracy by 6 family members in which 41 identities were used to fraudulently obtain over \$400,000 in student financial assistance. Some identities were obtained through identity theft, while individuals who expected to receive some of the proceeds from the scheme provided others. One of the defendants was responsible for recruiting 11 of the individuals whose identities were used. Most of the individuals whose identities were used lacked high school diplomas or GED certificates and were not eligible student financial assistance recipients. The defendants completed FAFSAs using their own addresses with the identities they obtained. They enrolled these individuals in online courses at a local community college. The school disbursed excess funds by mailing checks to the defendants’ addresses, and

the defendants retained the majority of these funds for their personal use. The defendants in this case pled guilty primarily to student financial aid and/or conspiracy charges.

Another OIG investigation found that an individual in Arizona used more than 50 identities, typically those of inmates serving long prison sentences, to obtain over \$316,000 in loans and grants (both FFEL and Pell grants involved). This scheme unraveled after a financial aid administrator at a local community college recognized the perpetrator, who had recently presented himself with a different identity in order to obtain a loan check, now seeking additional monies with yet another identity. As part of his plea agreement, the individual described his scheme, and his interview was used as a part of an educational DVD that has been distributed to Department program officials, campus police departments, and Members of Congress. I have provided copies to the Committee staff and would be happy to supply more.

OIG and FSA continue to jointly alert students to the threat of identity theft via our special campaign website, www.ed.gov/misused, which provides information on scams, suggestions for preventing identity theft, and resources on how to report identity theft involving federal education dollars. We also sent information on preventing identity theft to guaranty agencies and more than 50 college newspapers.

School Fraud and Abuse

Over 6,000 schools participate in the student financial assistance programs, and the Department relies on these schools to properly account for, and administer the funds. Fraud and abuse by school owners and officials have been a long-standing problem for the Department. It is a high-risk area that remains vulnerable. While fraud and abuse does occur at non-profit and public sector institutions, historically, fraud and abuse predominantly involves proprietary schools. In fact, over the last six completed fiscal years the majority – approximately 74 percent -- of our institutional fraud cases involved proprietary schools.

Proprietary schools have also evolved into two classes of institutions, privately held and as part of much larger publicly traded corporations. Both are driven by profit, but publicly traded institutions are also driven by growth. Over the years, we have identified rapid growth as one risk factor for abuse in the programs, through impaired administrative capabilities resulting in abuse or fraud. Examples of significant fraud and abuse we continue to find in school administration of the student financial assistance programs are refund violations and ineligible students, programs and locations.

Refund violations have been a longstanding problem in the student financial assistance programs, and it continues to challenge the Department. Refund violations 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 student financial aid funds, and return those funds to the Department, the FFEL loan holder, or to another applicable participant in the student financial assistance program 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, which 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.

Our office continues to find ineligible students due to falsification of high-school equivalence, ability-to-benefit exam results, not performing (or falsifying) required verification of income for selected students, and identity theft. We have found programs that do not meet the minimum requirements for program participation and additional institutional locations that did not meet the basic eligibility requirements. These are not frequent occurrences, but they continue.

As an example of the type of fraud we find in this area, my office recently conducted an investigation in Michigan related to the William Tyndale College (WTC). In March 2001, the WTC president and one vice president purchased the assets of a closed computer learning school and renamed the school the NorthStar Institute of Technology (NorthStar). Our investigation developed evidence that the WTC president and two vice presidents fraudulently misrepresented the NorthStar students as WTC students, using WTC's eligibility to apply for and receive student financial assistance funds for the NorthStar students. Between April 2001 and September 2001, NorthStar students, through WTC, were awarded \$943,025 in student financial assistance funds, of which \$517,414 was disbursed to WTC. Approximately \$318,000 was then funneled to NorthStar.

E-Signature/PIN

Protecting FSA's e-signature/PIN process is critical, as those PINs can be used not only to submit a FAFSA, but also to enter binding legal transactions, incur obligations to repay money, and control student aid accounts. While FSA encourages students to keep their PINs confidential and avoid disclosing them either intentionally or inadvertently, more needs to be done to ensure that the person using the PIN is the person actually authorized to do so. We have found at least one commercial site that assists in the completion of the FAFSA for a fee and encourages applicants to provide their PINs in order to do so. Addressing this risk is particularly critical as the number of FAFSAs filed electronically has increased significantly in the last two years.

Distance Education

The risk in distance education is ensuring students are actually enrolled and complete these courses. Schools may never have an in-person relationship with the student, making it more difficult to ensure the correct identity for the recipient of student financial assistance. The rapid growth of distance education, specifically via the internet, combined with the virtual paperless electronic delivery of student financial assistance funds contributes to this challenge

Lender Fraud and Abuse

With over 3000 lenders participating in the FFEL program, ensuring that each of these lenders is performing due diligence when servicing loans poses a challenge to the Department, and therefore a risk. Lender operations are complex, and lenders vary greatly in size. Billions of dollars are paid annually paid in subsidy costs, which are billed at an aggregate level. Further, errors in billings can result in millions in improper subsidy payments.

As an example of how critical due diligence is, we recently became aware that the New Hampshire Higher Education Assistance Fund (NHHEAF) notified FSA during 2002, that it discovered that it had assigned a large loan balance incorrectly under the category of loans billed at the 9.5 percent Special Allowance Payments. FSA required NHHEAF to calculate the overpayments, and have the recalculation reviewed by a certified public accountant firm. NHHEAF repaid the Department over \$10 million for overpayments during a several year period, including several thousand dollars in compounded interest.

Guaranty Agency Abuse

The ability to ensure that the 35 guaranty agencies involved in the FFEL program are carefully reviewing default claims to assure that proper due diligence was performed by the 3,000+ lenders and maintaining correct balance in the guaranty agencies' Federal and Operating Funds poses another challenge to the Department, and therefore was identified as a risk by the Fraud Initiative team.

We recently completed an audit of the Illinois Student Assistance Commission's (ISAC's) review of lender due diligence and found ISAC's claim review process was not adequate to ensure that it claimed reinsurance only if the lender exercised due diligence in servicing the loan. As a result of the problem identified at ISAC, we performed survey reviews at five of the largest guaranty agencies and found a similar lack of compliance.

Loan Discharges

The adequacy of the Department's new system to identify loan discharges is a concern, and significant enough to be considered a risk. In June 1999, OIG issued an audit reporting a significant lack of controls and abuse of the process to have student loans discharged due to disability and death of the borrower. In response to that audit, FSA implemented an entirely new process for disability discharges and implemented improved controls over discharges for death. Due to a wide range of complaints received by FSA over its process, we initiated an audit to assess the process and controls of its new system, which we will complete later this year.

Loan Consolidations

Lender non-compliance with regulations and, in some cases, fraud, present a risk in this area. Historically low interest rates have made the loan consolidations very attractive to

borrowers over the last several years. We have received a series of complaints regarding the activities of entities involved in loan consolidations and have completed an audit and several investigations.

We recently completed an audit of the Direct Consolidation Loan program and identified 65 FFEL lenders that did not return information required on the loan verification certificate (LVC), citing either the single-holder rule or asserting that the applicant was otherwise ineligible for a Direct Consolidation Loan. The single-holder rule does not apply to Direct Consolidation Loans, and lenders are not responsible for determining a borrower's eligibility for a Direct Consolidation Loan. If the Department did not receive a completed LVC, the loan was not consolidated. Instead, the Department sent a letter to the borrower, telling him or her that the loan could not be included in the consolidation unless the borrower successfully persuaded the loan holder to provide the information.

From the investigation side, based on our work, the owner/president of a debt collection agency in Arizona and four of his employees were indicted on 37 counts of bank fraud, student loan fraud and conspiracy. The individuals allegedly conspired to prepare fraudulent applications for consolidated student loans, so as to generate for themselves more than \$1 million in commissions. The bank handling the loans on behalf of the Department approved 537 of the loans worth more than \$3.6 million. Borrowers subsequently defaulted on 213 of the loans, causing a loss to the bank of \$1.4 million. No payments had been made by the borrowers on a majority of the original defaulted loans. The four employees have pled guilty and one has been sentenced. The trial of the owner is in progress, and the other three employees will be scheduled for sentencing after the completion of the owner's trial.

Monitoring Contractors in the Direct Loan Program

The risk in this program is conducting adequate monitoring of the contractors administering it (from origination through servicing of the loans). Oversight of the contractors is critical to the operation of the program, including ensuring adequate performance measures are established in the contract and ensuring deliverables are specific and monitored.

To demonstrate the impact of inadequate monitoring, we recently performed two audits of the Common Origination and Disbursement (COD) System, vital to the Direct Loan operations. On the audit of the COD contract, we found that contract requirements were not tied to COD performance, FSA lacked adequate oversight of contract deliverables, and FSA did not ensure continuation of service and adequate audit access to the system. In our audit of the COD system, we found numerous ongoing system interface and system balancing errors between COD and the Department's financial management systems, and ongoing problems with COD not automatically generating and linking student promissory notes with the student loan records, and COD not consistently providing schools with updated records, due to delays in processing batch information.

III. OIG Annual Work Plan

Through our annual work planning process we request suggestions from the Department, OMB, and Congress, on where to focus our limited resources. Our Work Plan is designed to support the management challenges we have identified for the Department, as well as the President's Management Agenda. As a result of this process, nearly 50 percent of OIG's work and resources are committed to the student financial assistance programs – their financial management, systems, operations, and activities.

Each year, we are required by statute to perform certain audits and reviews that cover the two loan programs. These include the financial statement audit of FSA and a review of information security, which includes major systems supporting the loan programs.

While we are still in the planning phases for our fiscal year 2006 Work Plan, some examples of audits in the student loan programs from our fiscal year 2005 Work Plan are:

- A review of the exceptional performer servicing of claims designation in the FFEL program. (Once a lender is designated as exceptional, it received 100 percent reimbursement on defaulted loans.);
- A review of compliance with Foreign School FFEL program Dear Colleague Letters geared to decrease the instances where FFEL borrowers falsely claim attendance at foreign schools and used the FFEL funds for other than their intended purpose; and
- Audits of external entities designed to identify improper payments to participants in the student loan programs, such as payments to guaranty agencies, subsidy payments to lenders, ineligible loans at schools, and ineligible borrowers.

Our current Work Plan also sets out investigations that we anticipate in the student loan programs such as investigations into schools' failure to refund tuition, ineligible locations and programs, falsified FAFSAs, and embezzlement.

IV. OIG Legislative Proposals

In January 2004, we submitted to Congress 20 recommendations for changes we believe are needed in the reauthorization of the HEA. These recommendations are supported by our audit, inspection, and investigative work in the student financial assistance programs. We urge you to consider each of these suggestions. Two of the most significant are to make persons convicted of such fraud no longer eligible to receive student financial aid and to increase the validity of the cohort default rates.

The first provision would serve as a deterrent for fraudulent activity. Persons who have fraudulently received student financial assistance funds should permanently lose their eligibility for any additional such funds. The Health and Human Services and Agriculture statutes have similar provisions for welfare and food stamp defrauders.

Although cohort default rates currently provide the information required under the HEA, they do

not appear to provide decision-makers with sufficient information on defaults in the student loan programs. Our proposal to increase the validity of the cohort default rates would shorten the number of days of delinquency before a loan is declared in default and eliminate borrowers in deferment or forbearance. These suggestions stem from an audit we conducted last year where we found that, under the current definition of cohort default, borrowers who enter repayment during the last two months of a cohort's fiscal year cannot default on their loans before the end of the following year. We also found that if a student receives a deferment or forbearance on a loan during the cohort's fiscal year or the following fiscal year, the student cannot default on the loan before the end of the following fiscal year, even if he or she never makes a payment on the loan.

As I noted earlier, I also want to again encourage Congress to support efforts to amend the Internal Revenue Code to allow the Department to match the information provided on students' applications with the income data that is maintained by the Internal Revenue Service. This action will go a very long way to identifying income inconsistencies and eliminating an area of fraud and abuse within the student financial assistance programs.

In closing, let me reiterate that I believe with the increased support of Congress, we can work with the Department to successfully address areas of risk in the student financial assistance programs, and help reduce waste, fraud and abuse in these important programs.

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