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ABSTRACT

This report presents information on what changes might strengthen the Department of Education's role as the "gatekeeper" for approving schools before their students can receive federal student aid. The review focuses on the proprietary (for profit) school sector. The report shows that adequate controls are not in place within the Department of Education to prevent financially weak schools and schools not providing promised training from participating in federal student aid programs. The report identifies six requirements that states are using in various degrees for licensing schools and that could be applied to strengthening the Department's eligibility and certification process. It is recommended that adoption of these requirements could provide a more rigorous means of screening schools and of establishing controls to better safeguard federal aid. The Department also recognizes the need for additional safeguards and is addressing similar issues. Appendices include the requirements states use in licensing proprietary schools and the major contributors to the report. (GLR)

United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Postsecondary Education, Committee on Education and Labor, House of Representatives

September 1991

STUDENT FINANCIAL AID

Education Can Do More to Screen Schools Before Students Receive Aid

GAO/HRD-91-145

GAO

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September 27, 1991

The Honorable William D. Ford
Chairman, Subcommittee on
Postsecondary Education
Committee on Education and Labor
House of Representatives

Dear Mr. Chairman:

This report responds to your request that we determine what changes might strengthen the Department of Education's role as the "gatekeeper" for approving schools before their students can receive federal student aid. In discussions with your office, we agreed to focus our review on the proprietary (for-profit) school sector in (1) determining what changes might strengthen the Department's role, (2) defining what procedures states use in licensing their schools, and (3) identifying state licensing requirements that could be used by the Department in improving the school approval process.

On July 17, 1991, we discussed the results of our analysis with your office. This report summarizes the information provided at that meeting.

Results in Brief

Adequate controls are not in place within the Department of Education to prevent financially weak schools and schools not providing promised training from participating in federal student aid programs. We identified six requirements that states are using in varying degrees for licensing schools that could be applied to strengthen the Department's eligibility and certification process (see app. I). Adoption of these requirements could provide a more rigorous means of screening schools and establish controls to better safeguard federal aid. The Department also recognizes the need for additional safeguards and is addressing similar issues.

Background

The Department of Education administers several student aid programs, including the Stafford Student Loan and Pell Grant Programs, under title IV of the Higher Education Act of 1965, as amended. To participate in the programs, schools must be (1) licensed by a state agency, (2) accredited by an agency recognized by the Secretary of Education, and (3) determined eligible and certified by the Department.

State licensing agencies play a role broadly defined as consumer protection that may include overseeing the content of schools' advertising and the maintenance of student records. Accrediting agencies are private organizations recognized as authorities on curriculum and other educational requirements to assure the quality of education offered by the schools.

Eligibility includes ensuring that schools are properly licensed and accredited. In this process, the Department relies heavily on accrediting agencies and state licensing when determining which schools can participate in federal student aid programs. Key aspects of certification include evaluating a school's financial responsibility and administrative capabilities.

Students can enroll in different kinds of postsecondary schools, ranging from proprietary schools to 4-year public and private schools. Proprietary schools differ from most postsecondary institutions in that they normally focus on short-term vocational training and generally do not award degrees, although some 2-year community colleges offer similar programs.

From 1985 to 1990, the number of schools with less than 2-year programs, most of which were proprietary schools, that participated in the student aid program increased by over 50 percent, from 2,761 to 4,337. The amount of loans received by proprietary school students almost doubled from $2.1 billion to $3.9 billion. During this period, the number of other types of schools increased slightly, while their loan volumes increased about 25 percent.

Loan defaults have risen dramatically—from about $900 million in 1985 to the Department's projection of $3.6 billion in 1991. Many of these defaults are attributed to proprietary school students. For example, the Department's most recent data for Stafford loan program borrowers entering repayment in fiscal year 1989 show that proprietary school borrowers were responsible for 71 percent of total default dollars.

Scope and Methodology

We reviewed our past and current work (see p. 20 for a list of related GAO products), congressional hearings, the Department's Office of Inspector General (OIG) reports, and other studies reporting that changes should be made to improve the federal gatekeeping process. We also interviewed officials from four states—California, Illinois, New York,

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and Texas. These states had recently made changes to their procedures for licensing proprietary schools.

During our review, we identified six requirements that could be used to strengthen the Department's eligibility and certification process. We obtained legislation for all 50 states and the District of Columbia to determine if they had these requirements in licensing proprietary schools. Our analysis was limited to changes that affect proprietary schools. We did not evaluate the effectiveness of the licensing requirements in each state.

Our review was conducted between January and September 1991 in accordance with generally accepted government auditing standards.

Eligibility and Certification Procedures Should Be Strengthened

The Department's procedures for approving schools to participate in federal student aid programs fail to scre- schools adequately. Several studies have identified weaknesses in the procedures the Department uses in determining a school's eligibility and certification. Stricter eligibility and certification procedures could prevent schools that are financially weak or fail to provide promised training from participating in federal student aid programs.

Some proprietary schools have increased the federal government's costs through high student loan default rates, inadequate internal controls, and other abusive practices. For example, some schools inaccurately reported their financial condition and lacked refund policies for students who left school before completing their periods of enrollment. In addition to government losses, students lose when they incur debt in the form of student loans and do not receive the education and skills the schools promised.

Uniform standards are not in place to screen schools before their students receive federal assistance. The Department relies on states' licensing requirements to ensure schools' eligibility. However, these requirements vary. Some states subject schools to rigorous requirements, while others allow almost any school to be licensed. Department officials told us they support uniform standards and would like the Congress to legislate minimum state licensing standards.

Several states have recently enacted or modified legislation to improve state licensing procedures to make schools more accountable to their students. These states have implemented approaches to licensure that could be applied to the federal eligibility and certification process.

Requirements Identified for Improving Federal Eligibility and Certification

Based on our review of the various studies and existing state legislation, we identified six requirements as most critical to strengthening the federal eligibility and certification procedures.

1. Outcome Measures

The Department holds schools accountable for only one outcome measure in its initial eligibility and certification process: having a withdrawal rate of 33 percent or less. The Office of Management and Budget (OMB), in its 1991 report on the Department's Office of Postsecondary Education, included an evaluation of the Department's eligibility and certification practices, and identified the need for additional outcome measures to track the success of schools' educational programs. It recommended collecting graduation and placement rates from all schools quarterly.

Under the Department's current procedures, schools with low job placement rates or with withdrawal rates that exceed 33 percent after initial certification are eligible for federal aid. For example, one school in Chicago, despite having an initial withdrawal rate of less than 33 percent, graduated only 100 of the 1,500 students enrolled and placed only 10 of the students who graduated.

Four states have specified outcome measures in their licensing requirements. For example, Florida requires a 50-percent completion rate. It also requires a 60-percent placement rate for students completing their courses. Placements must occur in the vocation for which students were trained. Florida also has established a computerized tracking program to determine whether each student graduating from an institution is properly placed.

2. Surety Bonds and Tuition Recovery Funds

The Department makes little effort to ensure that schools have the financial resources to protect students and the government from loss. For example, not all schools are required to purchase surety bonds or

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pay into tuition recovery funds. Schools buy these bonds or contribute to a recovery fund primarily to reimburse students who are owed refunds if schools close. However, the Department requires only schools that fail to meet its financial responsibility criteria of (1) a minimum one-to-one current ratio[1] and (2) a positive net worth[2] to submit a surety bond as a condition of certification for federal student aid. Since 1989, the Department has required schools that fail to meet its financial responsibility criteria to submit a bond equal to at least 25 percent of the financial aid received by their students. Department officials told us that if they had additional staff resources, they would be able to more closely monitor schools' financial condition.

As of September 1991, 224 (about 3 percent) of the over 8,000 schools participating in federal student aid programs were required to have a surety bond because they failed to meet the financial responsibility criteria. The total bond amounts for these schools is about $36 million, although their total funding is $260 million. In addition, the Department estimated that 500 schools that it does not require to have a surety bond would close in fiscal year 1991.

On September 5, 1991, the Department proposed changes to its regulations for proprietary schools that close. These changes would better protect students and the federal government by requiring that these schools adopt school closure plans, such as "teach-out" arrangements under which students at a closed school could attend another school at no additional cost, or participate in programs that guarantee tuition refunds to students. Department officials said that they are working with state licensing and accrediting agencies to develop a process for implementing this policy.

As a condition of licensure, 21 states require schools to submit a surety bond tied to gross tuition income to protect students and the government in the event of a school closure. In Illinois, for example, schools are required to provide a surety bond in an amount sufficient to cover any unused prepaid tuition the school may have in its possession. North Carolina requires schools to submit a bond that is at least equal to the maximum amount of prepaid tuition income held by the school at any one time.

[1]A current ratio consists of current assets, such as cash and accounts receivable, to current (short-term) liabilities. The Department requires schools' current assets to be equal to or greater than its current liabilities.

[2]Positive net worth is achieved when total assets exceed total liabilities.

Tuition recovery funds are also available for compensating students for lost tuition. These funds are statewide pools of monies that schools pay into that can be used to reimburse students if a school closes. Currently, 12 states require schools to contribute to a state-managed tuition recovery fund based on either an assessment per student or on a percentage of gross tuition income. For example, New York charges schools 0.3 percent of total gross tuition income to be applied to a tuition recovery fund. Two states, Arizona and Texas, have tuition recovery funds and require surety bonds. Some states have placed a ceiling on the amount any school would have to contribute to the fund.

3. Independently Audited Financial Statements

Schools are required to submit financial statements as a condition of participation in federal student aid programs; however, they are currently allowed to certify their own statements. If schools were required to have a third party audit their financial statements, the statements would be a more reliable indicator of their financial health. In May 1990, the Department proposed changing its regulations to require schools to submit annual financial statements audited and certified by an independent certified public accountant as a condition of eligibility. However, as of September 1991, the regulations had not been finalized.

Seven states require their schools to submit financial statements audited by an independent public or certified accountant as a condition of licensure. For example, schools in Arizona must submit financial statements that are prepared and signed by an independent public or certified accountant licensed by the state's board of accountancy. Texas requires schools, except those owned by one individual, to furnish a balance sheet that was audited by an independent public or certified accountant registered with the state accountancy board.

4. Minimum Refund Policy

The Department lacks a minimum tuition refund policy for schools, although it has a pro rata policy for schools with student borrower default rates over 30 percent. A pro rata refund is the amount of tuition a school refunds to students in proportion to the percentage of the course not completed. Schools with default rates under 30 percent are required to maintain a refund policy that is "fair and equitable" and is in compliance with accrediting and state licensing standards.

The State Higher Education Executive Officers, a national organization composed of state higher education officials, recommended that tuition refunds for students be based on the length of a term or semester and reimburse students on a pro rata basis. It also recommended that schools provide such refunds to students any time during the first half of the student's enrollment period and pay refunds within 45 days of the date a student withdraws.

Twenty-nine states require schools to reimburse some portion of a student's tuition through at least the first 50 percent of the period of instruction. California has one of the most stringent refund policies because it entitles students to receive refunds of all unearned tuition regardless of when they drop out of the program. For example, a student attending 90 percent of his or her program of instruction before withdrawing should receive a 10-percent refund.

5. Conditional Eligibility and Certification

Schools that become financially weak or administratively deficient after initial certification are not required to be recertified by the Department, thereby exposing students and the government to potential financial losses. In addition, few schools are initially denied certification. Between October 1987 and July 1990, 78 out of 912 schools (about 9 percent) were denied. Department officials told us that they have improved this process and denied certification for 55 out of 554 schools (about 10 percent) in fiscal year 1991.

OMB noted in its 1991 report that, once a school is certified, it is unlikely that it will be reviewed again unless a problem comes to the Department's attention through either a complaint or a referral from OIG or a state. In addition, OMB noted that a number of schools participating in student aid programs before 1978 did not have to undergo the certification process because it did not exist. Department officials said that the schools that existed before 1978 were mainly 4-year schools.

OMB also reported that, because schools' financial conditions can change and their enrollments can significantly increase once their students receive federal aid, schools should be granted conditional or limited certification when first allowed in the programs. Conditional certification and periodic recertification would require the Department to monitor more closely the financial stability and administrative capability of new schools. Under conditional certification, schools would be given limited access to federal funds for a certain period of time, such as 1 or 2 years.

Periodic recertification would require the Department to review its schools on a regularly scheduled basis, such as the 4-year requirement for redetermining eligibility. Department officials told us they believed that recertification is important although they would need additional staff to handle this additional requirement. The OIG has also recommended that schools be recertified periodically to ensure they continue to meet minimum administrative and financial criteria.

Six states require conditional licensing. For example, Florida gives new schools a 1-year conditional license, subjects them to stricter standards, and monitors them more closely than other schools.

6. Branch Campuses as Main Campuses

The law requires proprietary schools to be in operation for 2 years before their students are eligible for federal financial aid, but allows main campuses to establish branch campuses that are not subject to this 2-year requirement. Although the Department adopted a policy in August 1990 requiring all additional locations, including branch campuses, to be certified separately from the main campus of a school, branch campuses are still not subject to the legislative 2-year requirement.

An institution's affiliated branch campus may be physically separated from the main campus and may offer a field of training unrelated to that of the main campus. For example, OIG reported that a barber school with about 20 students established a masonry school as a branch campus several hundred miles away. Although the barber school was certified, the masonry school—whose enrollment quickly grew to 700 students—was not.

Concerns have also been raised about branch campuses because schools can expand their operations rapidly. For example, a school in Phoenix opened 20 branches between 1983 and 1986, growing in annual tuition from $2 million to $26 million. The school closed in 1987 owing students $15 million in refunds and leaving thousands of students without the education they paid for. Department officials said the Department is proposing changes to the regulations to require all branch campuses of schools subject to the 2-year requirement to be in operation for 2 years before they are eligible for federal student aid. However, as of September 1991, the regulations had not been finalized. Thirteen states require branch campuses to obtain a separate license. For example, California and Texas require branches to meet the same licensing standards as main campuses.

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Need for Stronger Federal Requirements

The Department lacks adequate procedures and requirements to screen schools when determining their eligibility and certifying them for participation in federal student financial assistance programs. The requirements we identified that are being used by some states in licensing schools may be adaptable for federal use. We were unable to conduct a formal evaluation of these requirements, but officials from several states we contacted said that they believe such requirements as pro rata refunds, surety bonds, and tuition recovery funds would make proprietary schools more accountable to students. These requirements would help ensure that minimum and consistent criteria are used in approving proprietary schools' participation in federal student aid programs.

Department officials said that the Department already has the authority to adopt some of the requirements we identified, but lacks the authority for others. For example, the Department is proposing regulations to require audited financial statements. They also believe that the Department has the authority to require surety bonds—and is using them on a limited basis for schools in weak financial condition.

These officials further believe that the Department lacks the authority to require outcome measures (such as placement rates) and to establish a period of conditional eligibility and certification. They were uncertain, however, about the Department's authority to establish pro rata tuition refund requirements that apply to all schools and to require branch campuses to be in operation for 2 years before participating in federal student aid programs.

Matters for Congressional Consideration

The Congress should consider amending the Higher Education Act to give the Secretary of Education the authority to implement and evaluate a range of procedures and requirements, such as those discussed in this report, to protect students and the federal investment in student financial aid programs.

As agreed with your office, we did not obtain written comments on this report. We did, however, discuss its contents with Department of Education program officials, who generally agreed with its findings. We incorporated their comments where appropriate.

We are sending copies of this report to other congressional committees, the Department of Education, and other interested parties. It was prepared under the direction of Franklin Frazier, Director, Education and Employment Issues, who can be reached at (202) 275-1793. Other major contributors are listed in appendix II.

Sincerely yours,

Lawrence H. Thompson

Lawrence H. Thompson
Assistant Comptroller General

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Abbreviations

GAO	General Accounting Office
OIG	Office of Inspector General
OMB	Office of Management and Budget

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Requirements States Use in Licensing Proprietary Schools

States	Outcome measures	Surety bonds[a]	Tuition recovery funds	Independent audit	Refunds[b]	Conditional license	Branch campus[c]
Alabama		X			X		
Alaska		X			X		
Arizona			X	X		X	
Arkansas			X		X		X
California	X		X		X		X
Colorado		X			X		X
Connecticut			X				
Delaware		X					
District of Columbia		X		X			X
Florida	X	X				X	
Georgia							X
Hawaii		X			X		
Idaho					X		
Illinois	X	X			X		
Indiana		X			X		
Iowa		X			X		
Kansas							
Kentucky						X	
Louisiana			X		X		X
Maine							
Maryland			X		X		X
Massachusetts		X		X	X		
Michigan		X					
Minnesota				X	X		
Mississippi							
Missouri		X					
Montana							
Nebraska						X	
Nevada						X	
New Hampshire		X					
New Jersey		X			X		
New Mexico					X	X	
New York			X		X		
North Carolina		X					
North Dakota					X		
Ohio			X				X
Oklahoma		X			X		X
Oregon	X	X			X		

(continued)

States	Outcome measures	Surety bonds[a]	Tuition recovery funds	Independent audit	Refunds[b]	Conditional license	Branch campus[c]
Pennsylvania		X			X		
Rhode Island		X			X		
South Carolina					X		
South Dakota				X	X		X
Tennessee			X		X		
Texas		X	X	X	X		X
Utah							X
Vermont							
Virginia			X		X		
Washington			X	X	X		X
West Virginia							
Wisconsin							
Wyoming					X		
Total	**4**	**21**	**12**	**7**	**29**	**6**	**13**
Percent	8	41	24	14	57	12	25

Note Information provided by the states

[a]Requires surety bond amounts to be tied to gross tuition income.

[b]Requires tuition refunds up through at least 50 percent of the course

[c]Requires branch campuses to apply for their own license to operate.

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Related GAO Products

Student Loans: Charactristics of Defaulted Borrowers in the Stafford Student Loan Program (GAO/HRD-91-82BR, Apr. 26, 1991).

Defaulted Student Loans: Analysis of Defaulted Borrowers at Schools Accredited by Seven Agencies (GAO/HRD-90-178FS, Sept. 12, 1990).

Supplemental Student Loans: Legislative Changes Have Sharply Reduced Loan Volume (GAO/HRD-90-149FS, Aug. 3, 1990).

Financial Problems in the Stafford Student Loan Program (GAO/T-HRD-90-52, July 27, 1990).

GAO Views on the Stafford Student Loan Program (GAO/T-HRD-90-13, Feb. 20, 1990).

Supplemental Student Loans: Who Borrows and Who Defaults (GAO/HRD-90-33FS, Oct. 17, 1989).

Guaranteed Student Loans: Analysis of Student Default Rates at 7,800 Postsecondary Schools (GAO/HRD-89-63BR, July 5, 1989).

Defaulted Student Loans: Preliminary Analysis of Student Loan Borrowers and Defaulters (GAO/HRD-88-112BR, June 14, 1988).

GAO's Views on the Default Task Force's Recommendations for Reducing Default Costs in the Guaranteed Student Loan Program (GAO/T-HRD-88-7, Feb. 2, 1988).

Guaranteed Student Loans: Legislative and Regulatory Changes Needed to Reduce Default Costs (GAO/HRD-87-76, Sept. 30, 1987).

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