

**FOR-PROFIT COLLEGE CONVERSIONS: EXAMINING
WAYS TO IMPROVE ACCOUNTABILITY AND
PREVENT FRAUD**

HEARING

BEFORE THE

**COMMITTEE ON EDUCATION AND LABOR
U.S. HOUSE OF REPRESENTATIVES**

ONE HUNDRED SEVENTEENTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, DC, APRIL 20, 2021

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**FOR-PROFIT COLLEGE CONVERSIONS:
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Tuesday, April 20, 2021

HOUSE OF REPRESENTATIVES,
COMMITTEE ON EDUCATION AND LABOR,
Washington, DC.

The committee met, pursuant to notice, at 10:19 a.m., via Zoom, Hon. Robert C. “Bobby” Scott (Chairman) presiding.

Present: Representatives Scott, Grijalva, Courtney, Sablan, Wilson, Bonamici, Takano, Adams, DeSaulnier, Norcross, Wild, McBath, Hayes, Levin, Stevens, Jones, Manning, Mrvan, Bowman, Pocan, Castro, Sherrill, Yarmuth, Foxx, Walberg, Grothman, Stefanik, Allen, Fulcher, Keller, Murphy, Miller-Meeks, Good, Harshbarger, Spartz, Cawthorn, Steel, and Letlow.

Staff present: Katie Berger, Professional Staff; Jessica Bowen, Professional Staff; Ilana Brunner, General Counsel; Christian Haines, General Counsel; Sheila Havenner, Director of Information Technology; Eli Hovland, Policy Associate; Ariel Jona, Policy Associate; Andre Lindsay, Policy Associate; Katie McClelland, Professional Staff; Max Moore, Staff Assistant; Mariah Mowbray, Clerk/Special Assistant to the Staff Director; Kayla Pennebecker, Staff Assistant; Veronique Pluviose, Staff Director; Benjamin Sinoff, Director of Education Oversight; Theresa Thompson, Professional Staff; Banyon Vassar, Deputy Director of Information Technology; Claire Viall, Professional Staff; Joshua Weisz, Minority Communications Director; Cyrus Artz, Minority Staff Director; Kelsey Avino, Minority Professional Staff Member; Courtney Butcher, Minority Director of Member Services and Coalitions; Amy Raaf Jones, Minority Director of Education and Human Resources Policy; Dean Johnson, Minority Legislative Assistant; Hannah Matesic, Minority Director of Operations; Audra McGeorge, Minority Communications Director; Carlton Norwood, Minority Press Secretary; Alex Ricci, Minority Professional Staff Member; Chance Russell, Minority Legislative Assistant; and Mandy Schaumburg, Minority Chief Counsel and Deputy Director of Education Policy.

Chairman SCOTT. OK we’re ready to begin and I’ll count down from five and then we’ll start. Five, four, three, two, one.

Good morning. The Committee on Education and Labor will now come to order. Our first order of business this morning is to conduct committee business to approve new committee assignments.

At this time, I’d like to welcome the Gentlelady from Louisiana’s 5th Congressional District to the committee, Ms. Letlow. And we’d

just like to begin by extending our condolences to you and your family on the passing of your husband, but I'm pleased that you've now joined the committee and we look forward to working with you on the committee.

Does the Ranking Member wish to be recognized?

Mrs. FOXX. I do Mr. Chairman.

Chairman SCOTT. Gentlelady is recognized.

Mrs. FOXX. Thank you, Mr. Chairman. I join all my colleagues in welcoming Representative Julia Letlow to the halls of Congress and to the Education and Labor Committee Republican team. It's been a difficult journey for Julia and her family as they continue to mourn the loss of Luke who tragically passed just days before he was to be sworn into office.

But he's certainly looking down with pride today. As the first female Republican elected in Louisiana, Dr. Letlow joins a strong freshman class of Republican women and mothers. And I have no doubt she'll serve her constituents and her State with distinction.

Dr. Letlow is a dedicated public servant who's worked in higher education for years, and we're overjoyed to welcome her with open arms to this committee. I'm eager to work alongside her in the days to come on behalf of America's students, workers, and job creators.

I ask unanimous consent that Dr. Letlow of Louisiana be appointed to the Subcommittees on Higher Education and Workforce Investment and Early Childhood Elementary and Secondary Education.

Chairman SCOTT. Is there any objection? Without objection so ordered. And if there's no further business before the committee the business portion of today's proceeding is concluded. And now we'll turn to today's committee hearing.

Once again, the, The Committee on Education and Labor will come to order. Welcome everyone. The committee is meeting today to hear testimony on For-Profit College Conversations: Examining Ways to Improve Accountability and Prevent Fraud.

This is an entirely remote hearing. All microphones will be kept muted as a general rule to avoid unnecessary background noise. Members and witnesses will be responsible for unmuting themselves when they are recognized to speak, or when they seek recognition.

I have also asked Members to identify themselves before they speak. Members should keep their cameras on while in the proceeding. The Members shall be considered present in the proceeding when they are on camera and are visible on camera. They shall be considered as not present when they are not visible on camera.

The only exception to this is if they're experiencing technical difficulty and inform committee staff of such difficulty. If any member experiences technical difficulties during the hearing, you should stay connected on the platform, make sure you are muted, and use your phone immediately to contact the committee's IT direct whose number was provided in advance.

Should the Chair experience any technical difficulty or need to step away from the floor, he'll designate another majority member to assume the gavel in my absence. This is an entirely remote

hearing and as such the committee hearing room is technically closed.

Members who choose to sit with their individual devices in the hearing room must wear headphones to avoid feedback, echoes, and distortion for more than one person on the software platform sitting in the same room.

Members are also expected to adhere to social distancing and safe healthcare guidelines, including the use of wearing masks, hand sanitizers, wiping down their areas both before and after their presence in the hearing room.

In order to ensure that the committee's five-minute rule is adhered to, staff will be keeping track of time using the committee's field timer. The field timer will appear on its own thumbnail picture and will be named 001_timer. This time provides no one-minute remaining warning.

The field timer will signal an audio when time is up. Members and witnesses are asked to wrap up promptly when their time has expired. A roll call is not necessary to establish a quorum in official proceedings conducted remotely or with remote participation.

The committee has made it a practice whenever there is an official proceeding with remote participation, for the Clerk to call the roll to help make clear who is present at the start of the proceeding. Members should state their name before announcing that they are present.

This helps the Clerk and also helps us watching the platform and the livestream who may be experiencing a few seconds delay. At this time, I ask the Clerk to call the roll.

The CLERK. Chairman Scott?

Chairman SCOTT. Chairman Scott is present.

The CLERK. Mr. Grijalva?

Mr. GRIJALVA. Raúl Grijalva present.

The CLERK. Mr. Courtney?

Mr. COURTNEY. Courtney present.

The CLERK. Mr. Sablan?

[No response.]

The CLERK. Ms. Wilson?

Ms. WILSON. Ms. Wilson is present.

The CLERK. Ms. Bonamici?

Ms. BONAMICI. Suzanne Bonamici is present.

The CLERK. Mr. Takano?

Mr. TAKANO. Takano is present.

The CLERK. Ms. Adams?

Ms. ADAMS. Alma Adams is present.

The CLERK. Mr. DeSaulnier?

[No response.]

The CLERK. Mr. Norcross?

[No response.]

The CLERK. Ms. Jayapal?

[No response.]

The CLERK. Mr. Morelle?

[No response.]

The CLERK. Ms. Wild?

Ms. WILD. Wild is present.

The CLERK. Mrs. McBath?

[No response.]
The CLERK. Mrs. Hayes?
[No response.]
The CLERK. Mr. Levin?
[No response.]
The CLERK. Ms. Omar?
[No response.]
The CLERK. Ms. Stevens?
Ms. STEVENS. Stevens present.
The CLERK. Ms. Leger Fernández?
[No response.]
The CLERK. Mr. Jones?
Mr. JONES. Jones is present.
The CLERK. Ms. Manning?
Ms. MANNING. Manning is present.
The CLERK. Mr. Mrvan?
Mr. MRVAN. Mrvan is present.
The CLERK. Mr. Bowman?
[No response.]
The CLERK. Mrs. McBath, I believe you're unmuted.
Mrs. MCBATH. McBath is present, thank you.
The CLERK. Mr. Pocan?
Mr. POCAN. Mr. Pocan is here.
The CLERK. Mr. Castro?
[No response.]
The CLERK. Ms. Sherrill?
Ms. SHERRILL. Sherrill's present.
The CLERK. Mr. Yarmuth?
Mr. YARMUTH. Yarmuth present.
The CLERK. Mr. Espailat?
[No response.]
The CLERK. Mr. Mfume?
[No response.]
The CLERK. Ranking Member Foxx? Mrs. Foxx you're unmuted,
or you're muted, I'm sorry.
Mrs. FOXX. Foxx is present.
The CLERK. Thank you. Mr. Wilson?
[No response.]
The CLERK. Mr. Thompson?
[No response.]
The CLERK. Mr. Walberg?
Mr. WALBERG. Walberg is present.
The CLERK. Mr. Grothman?
Mr. GROTHMAN. I'm present.
The CLERK. Ms. Stefanik?
[No response.]
The CLERK. Mr. Allen?
Mr. ALLEN. Allen present.
The CLERK. Mr. Banks?
[No response.]
The CLERK. Mr. Comer?
[No response.]
The CLERK. Mr. Fulcher?
Mr. FULCHER. Fulcher's present.

The CLERK. Mr. Keller?

[No response.]

The CLERK. Mr. Murphy?

[No response.]

The CLERK. Mrs. Miller-Meeks?

[No response.]

The CLERK. Mr. Owens?

[No response.]

The CLERK. Mr. Good?

Mr. GOOD. Good present.

The CLERK. Mrs. McClain?

[No response.]

The CLERK. Mrs. Harshbarger?

Mrs. HARSHBARGER. Harshbarger is present.

The CLERK. Mrs. Miller?

[No response.]

The CLERK. Mrs. Spartz?

[No response.]

The CLERK. Mr. Fitzgerald?

[No response.]

The CLERK. Mr. Cawthorn?

Mr. CAWTHORN. Cawthorn is present.

The CLERK. Mrs. Steel?

Mrs. STEEL. Steel present.

The CLERK. Ms. Letlow?

Ms. LETLOW. Letlow is present.

The CLERK. Thank you. Chairman Scott that concludes the roll call.

Chairman SCOTT. Thank you, did anyone appear after the roll call that wants to be recorded as present?

Mrs. HAYES. Mrs. Hayes Mr. Chair, I'm present.

Chairman SCOTT. Thank you. Anyone else? Thank you. Pursuant to Committee Rule 8(c) opening statements are limited to the Chair and Ranking Member. This allows us to hear from our witnesses sooner and provides all Members with adequate time to ask questions.

I recognize myself now for the purpose of making an opening statement.

Today we're gathered to discuss the need for strong oversight to protect students and taxpayers from those for-profit colleges that transition to non-profit institutions to trick students and regulators. Over the last 4 years this committee has had extensive discussions over the role of for-profit colleges and our higher education system.

This work continues to be guided by the clear evidence that some unscrupulous for-profit colleges frequently charge their students too much in tuition on delivering too little in education and opportunity.

After a series of high-profile cases in which for-profit colleges cheated students and taxpayers out of billions of dollars, regulators and potential students have become more aware of the deceptive practices employed by bad actors in the for-profit sector.

But rather than changing their behavior to comply with the accountability standards and repair the industry's reputation, some

schools are opting to simply evade the for-profit accountability standards and are re-branding themselves as non-profits.

Three months ago, the Government Accountability Office, or the GAO, released a report identifying 59 for-profit colleges that converted to non-profit status over the past decade. A report found several examples of for-profit schools that sought to become non-profit in name only.

In roughly a third of the conversions identified by the GAO, the for-profit colleges owners or officials, held leadership roles in the non-profit buyer. As a result of poor oversight by both the Department of Education and the Internal Revenue Service, these conversions sometimes took place without the necessary oversight to prevent self-dealing.

In two instances the IRS approved the sale among for-profit insiders without essential information such as the planned purchase price, or the appraisal of the college's value. This has left the IRS staff with no way of knowing whether the price was improperly inflated.

Emergence of covert for-profits has real consequences for students and taxpayers. For example, an independent analysis found that in 2011 Florida-based Keiser University attained non-profit status after the owner sold it to its own non-profit entity, Everglades College, in what appeared to be a significantly inflated price.

To finance the sale the owner lent more than 300 million dollars to Everglades College in addition to claiming a massive tax-deductible donation. The resulting conversion allowed the owner to profit from the sale of his business and keep millions of dollars in tax breaks.

During the same period, the university settled multiple investigations with law enforcement agencies for violating State and Federal consumer protection laws. We cannot allow these kinds of things to continue.

As GAO found both the Department of Education and the IRS must do more to prevent fraud by properly vetting for profit to non-profit conversions. They must ensure that after the conversion the for-profit institutions uphold their obligations to put students first and not profits.

The College Affordability Act, which the committee considered last year offers a clear foundation for legislative solutions to achieve these goals. A comprehensive bill included several provisions that established requirements an institution must meet to convert to non-profit status.

These requirements include demonstrating that the asset it acquires from the former owners are not acquired at a value greater than its actual worth; and demonstrating that no member of its governing board receives any substantial economic benefit.

Today we are grateful to be joined by expert witnesses who will help us discuss these solutions and other proposals that will ensure that for-profit college executives cannot take advantage of converting to non-profit institutions.

This is a critical moment to take action as students recover from the pandemic and start or continue their pursuit of post-secondary education. We must ensure that students and taxpayers are pro-

tected from deceptive schemes that undermine the integrity of our higher education system.

At this point, I am pleased to recognize the distinguished Ranking Member for the purpose of making her opening statement. Dr. Foxx.

[The statement of Chairman Scott follows:]

STATEMENT OF HON. ROBERT C. "BOBBY" SCOTT, CHAIRMAN,
COMMITTEE ON EDUCATION AND LABOR

Today, we are gathered to discuss the need for stronger oversight to protect students and taxpayers from those for-profit colleges that transition to non-profit institutions to trick students and regulators.

Over the last four years, this Committee has had extensive discussions over the role of for-profit colleges in our higher education system. This work continues to be guided by the clear evidence that some unscrupulous for-profit colleges frequently charge their students too much in tuition while delivering too little in education and opportunity.

After a series of high-profile cases in which for-profit colleges cheated students and taxpayers out of billions of dollars, regulators and potential students have become more aware of the deceptive practices employed by bad actors in the for-profit sector.

But rather than changing their behavior to comply with accountability standards and repair the industry's reputation, some schools are opting to simply evade for-profit accountability standards by rebranding themselves as non-profits.

Three months ago, the Government Accountability Office, or GAO, released a report identifying 59 for-profit colleges that converted to non-profit status over the past decade.

The report found several examples of for-profit schools that sought to become non-profit in name only. In roughly a third of conversions identified by GAO, the for-profit colleges' owners or officials held leadership roles in the non-profit buyer.

As a result of poor oversight by both the Department of Education and the Internal Revenue Service, these conversions sometimes took place without the necessary oversight to prevent self-dealing.

In two instances, the IRS approved a sale among for-profit insiders without essential information, such as the planned purchase price or appraisal of the college's value. This left IRS staff with no way of knowing whether the price was improperly inflated.

The emergence of 'covert for-profits' has real consequences for students and taxpayers.

For example, an independent analysis found that, in 2011, Florida-based Keiser University attained non-profit status after the owner sold it to his own non-profit entity, Everglades College, at what appeared to be a significantly inflated price. To finance this sale, the owner lent more than \$300 million dollars to Everglades College in addition to claiming a massive tax-deductible donation. The resulting conversion allowed the owner to profit from the sale of his business and keep millions of dollars in tax breaks.

During this same period, the university settled multiple investigations with law enforcement agencies for violating State and Federal consumer protection laws.

We cannot allow these kinds of things to continue. As GAO found, both the Department of Education and IRS must do far more to prevent fraud by properly vetting for-profit to non-profit conversions. And they must ensure that, after the conversion, for-profit institutions uphold their obligations to put students first— profits.

The College Affordability Act, which the Committee considered last year, offers a clear foundation for legislative solutions to achieve these goals. The comprehensive bill included several provisions that established requirements an institution must meet to convert to nonprofit status. These requirements include demonstrating that the assets it acquires from former owners are not acquired at a value greater than its actual worth; and demonstrating that no member of its governing board receives any substantial economic benefit.

Today, we are grateful to be joined by expert witnesses who will help us discuss these solutions and other proposals that will ensure that for-profit college executives cannot take advantage of converting to non-profit institutions.

This is a critical moment to take action as students recover from the pandemic and start or continue their pursuit of post-secondary education. We must ensure students and taxpayers are protected from deceptive schemes that undermine the integrity of our higher education system.

At this point, I am pleased to recognize the distinguished Ranking Member for the purpose of making her opening statement.

Mrs. FOXX. Thank you, Mr. Chairman. Our education system is in crisis. High school graduation rates are declining, the Nation's skill gap is growing, COVID-19 pandemic policies have led to years-worth of learning loss, Federal student debt tops 1.5 trillion dollars, college costs continue to skyrocket, campus free speech is under attack and China is infiltrating U.S. Campuses.

All these issues are deserving of Congress's time and attention. So, you could imagine my surprise when I learned we were ignoring these important pressing topics to examine colleges transitioning from for-profit to non-profit status, which impacts roughly 0.1 percent of for-profit colleges per year, or approximately three schools a year.

Three schools a year. In the past decade, only 35 such colleges transitioned to non-profit status. Whoopie. So, the millions of students wondering why Congress hasn't acted on campus free speech zones, Chinese Communist party censorship, and exorbitantly high tuition rates, I say look no further than this hearing today, and see where the democrat's priorities are.

Democrats want to discuss the possibility of a narrow type of fraud in higher education. Specifically, the potential for some stakeholders to receive improper benefits when non-profit organization acquire for-profit colleges.

Committee Republicans are against all fraud and abuse, no matter the tax status of the institution. That bears repeating. Committee Republicans are against all fraud and abuse no matter the tax status of the institution. Sadly, Democrats are more interested in chasing phantoms than they are working with republicans on issues that are actually important to students.

Republicans will continue our work to improve the odds that students succeed after attending post-secondary education. But let's return to why democrats called this hearing. I'd like to make several important points about the Government Accountability Office (GAO) report Democrats will highlight, which investigated when for-profit colleges became non-profit entities.

First, transitioning from for-profit to non-profit is completely legal. Second, if any of my Democrat colleagues read past the report's title, they would know two of the three GAO recommendations are outside the committee's jurisdiction. Additionally, the GAO report flagged that one-third of the 35 proprietary institutions that became non-profits had insider involvement.

While that term may sound nefarious, it's a far cry from real harm inflicted upon students which is where we should be focusing our efforts and attention. So, the obverse of one-third of the institutions having insider involvement means two-thirds did not.

Today's hearing is just another example of Democrats trying to manufacture headlines to advance their partisan objectives, even if those policies limit student choice and freedom. As I repeatedly said oversight is a critical function of Congress, and we must protect use of taxpayer funds, a responsibility I take very seriously.

But this hearing fails to address substantively the ways higher education fails students. President Obama presided over several of

these transitions, but Democrats remained suspiciously quiet. Now we're coming off 4 years of President Trump whose Department of Education strengthened the bureaucratic review of this non-profit conversion process.

We're fabricating a crisis to rally support for a socialist overhaul of our education system. It wasn't a pressing problem 8 years ago, and with the GAO determining there's been no fraud, it is a pressing problem now. The Federal Government should not be in the business of picking winners and losers, yet Democrats are actively working to eliminate proprietary institutions.

For a party that loves to talk about diversity in higher education, it is ironic they are attacking institutions that educate hundreds of thousands of minority students, veterans, older Americans, and single parents. The Higher Education Act is in desperate need of reform, so all colleges—not just those the democrats demonize, are held accountable and better serve students.

When it comes to post-secondary education the question we should be asking is whether students are getting the education they need to be successful. Unfortunately, even before the pandemic disrupted schools, jobs, and families, polling suggested that 53 percent of recent college graduates are unemployed or underemployed. At the same time millions of jobs sit unfilled due to the skills gap, demanding more students obtain a skills-based education, which many proprietary institutions offer.

Those are the issues facing students in higher education, not whether the president of a for-profit university kept his job while the university's tax status changed. While the purpose of today's hearing is questionable, I look forward to hearing from our witnesses and engaging in positive conversation.

[The statement of Ranking Member Foxx follows:]

STATEMENT OF HON. VIRGINIA FOXX, RANKING MEMBER,
COMMITTEE ON EDUCATION AND LABOR

Our education system is in crisis.

High school graduation rates are declining, the Nation's skills gap is growing, COVID-19 pandemic polices have led to years' worth of learning loss, Federal student debt tops 1.5 trillion dollars, college costs continue to skyrocket, campus free speech is under attack, and China is infiltrating U.S. campuses.

All these issues are deserving of Congress' time and attention, so you can imagine my surprise when I learned we were ignoring these important, pressing topics to examine colleges transitioning from for-profit to non-profit status, which impacts roughly zero-point one percent of for-profit colleges per year, or approximately three schools a year. In the past decade only 35 such colleges transitioned to non-profit status.

So, to the millions of students wondering why Congress hasn't acted on campus free speech zones, Chinese Communist party censorship, and exorbitantly high tuition rates—I say look no further than this hearing today.

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Additionally, the GAO report flagged that one-third of the 35 proprietary institutions that became non-profits had insider involvement. While that term may sound nefarious, it is a far cry from real harm inflicted upon students, which is where we should be focusing our efforts and attention.

Today's hearing is just another example of Democrats trying to manufacture headlines to advance their partisan objectives, even if those policies limit student choice and freedom.

As I have repeatedly said, oversight is a critical function of Congress, and we must protect the use of taxpayer funds—a responsibility I take very seriously. But this hearing fails to address substantively the ways higher education has failed students. President Obama presided over several of these transitions, but Democrats remained suspiciously quiet. Now that we are coming off four years of President Trump, whose Department of Education strengthened the bureaucratic review of this non-profit conversion process, we are fabricating a crisis to rally support for a socialist overhaul of our education system. It wasn't a pressing problem eight years ago and with the GAO determining there's been no fraud, it isn't a pressing problem now.

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The Higher Education Act is in desperate need of reform, so all colleges ? not just those Democrats demonize ? are held accountable and better serve students.

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Unfortunately, even before the pandemic disrupted schools, jobs, and families, polling suggested 53 percent of recent college graduates are unemployed or underemployed. At the same time, millions of jobs sit unfilled due to the skills-gap, demanding more students obtain a skills-based education which many proprietary institutions offer.

Those are the issues facing students and higher education, not whether the president of a for-profit university kept his job when the university's tax status changed.

While the purpose of today's hearing is questionable, I look forward to hearing from our witnesses and engaging in productive conversation. I yield back.

And Mr. Chairman before I yield back, I'd like to yield to Dr. Letlow for a very brief opening statement.

Chairman SCOTT. The Gentlelady from Louisiana is recognized.

Ms. LETLOW. Good morning, Chairman Scott, Ranking Member Foxx, Members of the committee and witnesses. I'm honored to join this distinguished committee, and to have the opportunity to represent the teachers, professors, principals, administrators, and students of the 5th District of Louisiana.

As a former higher education administrator, this committee holds a special place in my heart. I am pleased to be able to be on a committee that will help shape education and workforce policies for years to come. I firmly believe education is the key to success. We must do all we can to ensure our students have the opportunity to learn, grow, and find career opportunities that best suit their talents.

We must pave the way for our children to be able to choose any route of education they wish to pursue, whether trade schools, community colleges, or universities. Utilizing public-private partnerships for workforce education is paramount. Additionally, there are a unique set of challenges that our rural schools face, including access to broadband and teacher recruitment and retention.

I look forward to working together to tackle these pressing issues. I'm excited to begin working with you all to better educational programs, and workforce opportunities for my constituents and individuals across the country. Thank you and I yield back my time.

Ms. FOXX. Thank you for your indulgence, Mr. Chairman. I yield back.

Chairman SCOTT. No problem. Thank you. Without objection all other Members who wish to insert a written statement into the record may do so by submitting them to the Committee Clerk electronically, in Microsoft Word format by 5 p.m. on May 4, 2021.

I will now introduce the witnesses. Yan Cao is a Senior Fellow at the Century Foundation where she works on higher education policy with a focus on expanding opportunity, reducing inequality, and ensuring fair outcomes for students.

She previously worked as a Skadden Fellow at the Project on Predatory Student Lending at the Legal Services Center at Harvard Law School, representing students defrauded by for-profit colleges, and as an attorney at South Brooklyn Legal Services, representing low-income families with predatory student loan debt. She received her bachelor's degree from Stanford, and a J.D. from New York University.

Brian Galle is a Professor of Education at Georgetown University. His research and teaching interests include taxation, non-profit organizations, behavioral law and economics, federalism, and public finance economics. He practiced for 3 years as an attorney in the criminal appeals and tax enforcement policy section of the tax division at the U.S. Department of Justice.

He's a graduate of Harvard College, received a J.D. from Columbia and an LL.M. from Georgetown.

Andrew Gillen is the Senior Policy Analyst for the Texas Public Policy Foundation and an adjunct professor in economics at John Hopkins University. He's spent over a decade of non-profit and philanthropic organizations researching ways to improve post-secondary education.

Previous places of employment include the Charles Koch Foundation, the American Institutes for Research, American Council of Trustees and Alumni, the Center for College Affordability and Productivity. He also served on the U.S. Department of Education's Advisory Committee on Student Financial Assistance.

He has a Ph.D. in economics from Florida State and a BA in business from Ohio University.

Melissa Emrey-Arras is the Director of GAO's Education Workforce and Income Security Issues team. She oversees the GAO's higher education reports, has led studies examining issues ranging from for-profit college conversions to student loans.

Before joining GAO in 2001 she worked in the private sector consulting company and conducted program evaluations for State and local governments. She has received a master's degree of public policy from Harvard's Kennedy School where she was awarded the Manuel C. Carballo prize for graduate research, and she also has a bachelor's degree from Swarthmore College.

I appreciate all of the witnesses participating today and look forward to your testimony. Let me remind the witnesses that we've

read your written statements and they will appear in full in the hearing record.

Pursuant to Committee Rule 8(d) and the committee practice, each of you is asked to limit your oral presentation to a five-minute summary of your written statement. Before you begin your testimony, please remember to unmute your microphone. During your testimony staff will be keeping track of time and the timer will sound when time is up.

Please be attentive to the time and wrap up when your time is over and then re-mute your microphone. If you experience technical difficulties during your testimony, or later in the hearing, you should stay connected, make sure that you're muted, and use your telephone to immediately call the committee's IT director whose number was provided to you in advance.

We will let the witnesses make their presentations before we move to member's questions. When answering a question please remember to unmute your microphone. Witnesses are aware of their responsibility to provide accurate information to the committee, and therefore we will proceed now with their testimony.

We will first recognize Ms. Cao. Ms. Cao?

**STATEMENT OF YAN CAO, JD, FELLOW, THE CENTURY
FOUNDATION**

Ms. CAO. Thank you, Chairman Scott, for the opportunity to testify today, and to Mr. Vassar for assistance with slides today. Before we dive into the complex conversations the GAO has described in its report, I want to start with the basics. How do you close the skills gap, expand opportunity, and provide a fighting chance to students who have suffered from chronic underinvestment in their prior education?

Ask any high school principal and she'll tell you, "Invest resources in students." With the Higher Education Act, Congress has made an enduring investment in student's higher education, but not all of those resources reach the students who need them the most. In the for-profit sector, taxpayer dollars earmarked for higher education can be extracted by insiders for personal gain.

To understand why this matters, focus on the gap between the tuition dollars that students pay in, and the educational investments that students get out of institutions. Now at traditional non-profit schools, 100 percent of that difference must be reinvested toward education.

At for-profit schools, the gap between high tuition and low educational spending can be extracted by insiders. This distinction between revenue extracting schools, and revenue reinvesting schools makes a huge impact on incentives, behaviors, and student outcomes.

There are two paths for maximizing revenue—high tuition, and high-pressure recruitment. High tuition translates to more debt. At Keiser University a conversion described in the GAO report, every program has a median debt of \$30,000.00 or higher. This is true for less than 5 percent of public college programs.

High pressure recruitments leads to fraudulent tactics. Together, revenue extracting schools account for 99.7 percent of borrower defense claims that that have been identified by an institution. Once

revenue extracting schools max out revenue, the other side of the equation is minimizing investment in students.

For every one dollar of student tuition, for-profits average just 29 cents of student instruction. Some for-profit conversions are even worse. Grand Canyon University reports to spending 18 cents on instruction for every student tuition dollar. The same high-price, low-value formula that produces big profits for owners leads to drop-outs, loan defaults, and worthless degrees for students.

In some cases, for-profit conversions produce outcomes that are even worse for students than those at traditional for-profit schools. Congress and the Department of Education have taken steps to protect students from the heightened risks associated with revenue extracting institutions.

For-profit colleges sometimes describe these sector-specific regulations as an unfair additional burden, but this is disingenuous. Let's take an example. When for profit owners have withdrawn investments to the point of near collapse, regulations then limit further withdrawals of capital.

This rule singles out for-profits for a simple reason, non-profit owners can never withdraw capital. As the example illustrates, for-profit regulations are not added burden on revenue extracting institutions. Instead, they are guardrails for institutions that lack the non-profit sector's absolutely barrier against enrichment.

Private institutions have two choices—either give up the revenue extraction power and reinvest 100 percent of resources in student education, or retain the revenue extraction power, but abide by student protection guardrails.

For-profit conversions want to have their cake and eat it too. They want revenue extraction power without the guardrails. This combination presents the greatest risk to students and taxpayers. Students intuitively believe that non-profits will be safer than for-profit schools, but the revenue extracting for-profit conversions are in fact even more dangerous than for-profit schools that are subject to appropriate regulations like 90/10 or the Gainful Employment Rule.

For-profit conversions are not just wolves in sheep's clothing, they are wolves that have sharpened their teeth and honed their claws while the shepherd is off minding other wolves. The good news is that the Department of Education already has the tools that it needs.

To protect students the department must engage in its own review to root out schools with hidden revenue extraction plans. As we continue this discussion, I ask that you keep three students in mind.

First, a student at school suddenly collapses because owners have withdrawn too much equity for the school to remain viable. Second, a student who owes more loan debt that she can ever repay because her school took her tuition, but grossly underinvested in her education.

Third, a veteran who has learned not to trust the predatory school that recruits on base but does not know that the global campus with the public name is operated by the same company. These are the victims of for-profit conversions, and I urge you to ensure that they receive the full benefit of the investment and protections

secured by the Higher Education Act. Thank you, and I look forward to answering your questions.

[The prepared statement of Ms. Yan Cao follows:]

PREPARED STATEMENT OF YAN CAO



Testimony of Yan Cao, The Century Foundation,
to the U.S. House of Representatives,
Education & Labor Committee

Tuesday, April 20, 2021

**Full Committee Hearing: For-Profit College Conversions: Examining Ways
to Improve Accountability and Prevent Fraud**

Thank you for the opportunity to testify today. I am an attorney and Fellow at The Century Foundation, a progressive nonpartisan think tank that seeks to foster opportunity, reduce inequality, and promote security at home and abroad. Our education program addresses issues of school diversity, college affordability, consumer protection, and accountability.

Over the past six years, The Century Foundation has published numerous reports highlighting the risks associated with dubious for-profit college conversions¹—risks that have now been meticulously researched and documented by the Government Accountability Office (GAO) in its January 2021 report: “*Higher Education: IRS and Education Could Better Address Risks Associated with Some For-Profit College Conversions.*”²

When examining these conversions it is easy to get lost in the details of the complex corporate shell games predatory colleges play when they want to avoid standards and accountability. But make no mistake, these conversions, at their core, are about whether the most vulnerable students—low-income, minority, and first-generation students who have borne the brunt of educational underinvestment their entire lives—will have a genuine shot at a high-quality education, or whether sophisticated and well-lawyered corporations will be allowed to pull the wool over students’ eyes, rip them off while posing as nonprofits, and divert students’ precious tuition dollars for private enrichment. If unchecked, false for-profit conversions will result in fewer Title IV resources reaching the students who need them the most and more students who are harmed by predatory schools posing as charitable actors.

¹ Examples of The Century Foundation publications on for-profit conversions, also described as “Covert For-Profits,” include: *The Covert For-Profit* (2015); *Was Wright Wrong? Early Warnings of Covert For-Profit Colleges* (2017); *Purdue University Global Is a For-Profit College Masquerading as a Public University* (2018); *These Colleges Say They’re Nonprofit—But Are They?* (2018, updated 2020); *How For-Profits Masquerade as Nonprofit Colleges* (2020); *Dubious Conversions of For-Profit Colleges: Decoding the GAO Report* (2021).

² Available at <https://www.gao.gov/products/gao-21-89>.

How do you close the equity gap, expand opportunity, and lift students out of poverty? Ask any high school principal and she'll tell you: invest resources in students.

With Title IV of the Higher Education Act (HEA), Congress has made an enduring investment of resources to support students in higher education. But, unfortunately, not all of those resources reach the students who need them the most: In one sector of higher education, taxpayer dollars earmarked for higher education can be extracted and diverted for the personal enrichment of owners. This feature is the hallmark of the for-profit sector and, increasingly, of for-profit colleges that use complex conversions, corporate shells, and regulatory arbitrage to blur the lines between for-profit and tax-exempt nonprofit status.

As a formal matter, the HEA recognizes three arbiters of nonprofit status. First, institutions call themselves non profit if they register that way with a state. Second, state-recognized nonprofits typically seek tax-exempt status from the IRS. Third, IRS-approved tax-exempt entities may apply to the Department of Education to be recognized as nonprofits under the Higher Education Act. Each of these gatekeepers is reflected in one prong of HEA's three-part for nonprofit status: one prong looks to the states, a second looks to IRS, a third and final prong is reserved for the Department of Education's independent assessment of whether an institution diverts Title IV resources for "the benefit of any private shareholder or individual."³

In the context of higher education, for-profit status is not just an obscure tax designation. Rather, it is a choice made by owners that preserves their power to take resources from a college's coffers—from revenues that come in as students' tuition dollars, federal loans, and GI Bill benefits—and divert those resources for individual enrichment rather than educational investments.

I. The Power to Extract Resource Defines For-Profit Status

The defining difference between the schools ED regulates as for-profit and the schools ED regulates as nonprofit lies in the gap between the tuition dollars that come in and the resources that are invested in students' educations.

- At for-profit schools, the gap between tuition and educational spending can be used to enrich owners.
- At traditional nonprofit schools, 100% must be reinvested in the schools' educational mission.

³ See 34 CFR § 600.2(i)(i)-(iii) (defining "nonprofit institution"); see also 20 U.S.C. § 1003(i)(3) (defining "nonprofit" in part as an institution "no part of the net earnings of which inures, or may lawfully inure, to the benefit of any private shareholder or individual.").

This distinction has produced huge differences in the incentives, behaviors and student outcomes of *revenue-extracting schools* (which include for-profit schools and some conversions) versus *revenue-reinvesting schools* (which include traditional nonprofit and public schools).

When insiders can extract the difference between high tuition rates and low investments in students' education, they tend to inflate tuition and depress educational investment.⁴ By contrast, when the decision-makers know that any difference between tuition charges and educational investments must be reinvested for educational purposes, tuition stays lower and educational investment is much higher. On average, for every dollar of debt that a student takes on, nonprofit institutions invest \$0.84 in that student's instruction while for-profit institutions invest only \$0.29 per tuition dollar in student instruction.⁵

II. **Resource-Extracting Institutions Create Risks for Students**

By every measure, *revenue-extracting institutions are worse for students* compared to revenue-reinvesting institutions.

Revenue-extracting schools employ two strategies to maximize the funds available for extraction: raise tuition to capture more revenue-per-student and use aggressive recruitment to enroll more students. In addition to maximizing revenue, revenue-extracting schools preserve profits for insiders by minimizing investment in students. These tactics are well documented among for-profit schools⁶ and, despite their charitable claims, many for-profit conversions behave in much the same way.

- **Higher prices means deeper debt** for students at revenue-extracting institutions. Less than five percent of public college programs leave bachelors students with \$30,000 of debt or more, but two-thirds of for-profit colleges programs generate debt at that level.⁷ Worse, over 80 percent of programs at revenue-extracting nonprofits leave students with over \$30,000 in debt. At for-profit conversion Keiser University, every last program leaves students with a median debt level over \$30,000.
- **Volume-driven enrollment means predatory recruitment** at revenue-extracting institutions. Several conversions—such as the conversion of for-profit Education Management Corporation (EDMC) schools, including the **Art Institutes**, **Argosy**

⁴ The Century Foundation's publications on instructional spending rates include [How Far Does Your Tuition Dollar Go?](#) (2019); [TCF Estimates 'Bang for Tuition Buck' at More than 5,000 Colleges Nationwide](#) (2019).

⁵ *Id.*

⁶ See The Century Foundation series, "[THE CYCLE OF SCANDAL AT FOR-PROFIT COLLEGES](#)" (2017-18).

⁷ College Scorecard data on the median student loan debt of graduates from bachelor's programs.

University, and South University, to Dream Center Holdings⁸; for-profit Kaplan University's conversion to **Purdue University Global**⁹; and for-profit **Ashford University**'s proposed conversion to University of Arizona Global Campus¹⁰—involve for-profit schools that were investigated for operating high-pressure sales centers. In each of these instances, the conversion rewarded past predatory recruitment practices, retained aggressive sales managers, and incentivized further predatory tactics through revenue-share agreements and incentive-based payments.¹¹ While predatory recruitment is lucrative for revenue-extracting schools, it is disastrous for students and taxpayers. As of December 2020, the Department of Education had identified 268 institutions with 100 or more borrower defense claims: 263 of these were for-profit schools or conversions.¹²

- **Preserving profits means low educational investment** at revenue-extracting institutions. On average, for every dollar of debt that a student takes on, nonprofits spend \$0.84 on instruction while for-profits spend \$0.29.¹³ Educational investment at covert for-profits reflect the priorities of revenue-extracting institutions: for example **Purdue University Global**, a for-profit conversion that formerly operated as Kaplan University, spends just \$0.13 on instruction for every tuition dollar it receives. Another for-profit conversion, **Grand Canyon University**, spends \$0.18 on instruction for each student tuition dollar. For-profit **Ashford University** spends only \$0.19 on instruction for each tuition dollar, and, as part of its currently-pending conversion contract with the University of Arizona, Ashford's parent company, Zovio, has effectively placed a two percent cap on instructional increases for the next fifteen years.¹⁴ Notably, the contract did not cap

⁸ U.S. Department of Justice, Press Release: [For-Profit College Company to Pay \\$95.5 Million to Settle Claims of Illegal Recruiting, Consumer Fraud and Other Violations](#) (November 16, 2015).

⁹ Separate law enforcement actions against Kaplan Higher Education and parent, Graham Holdings, have been initiated by numerous agencies, including: U.S. Department of Justice - Pennsylvania (2008), Attorney General - Delaware (2011), Office of the Attorney General - Florida (2010), Attorney General - Illinois (2011), Attorney General - Massachusetts (2011), Attorney General - North Carolina (2012), U.S. Department of Justice - Texas (2015). See generally, David Halperin, Republic Report, "[Law Enforcement Investigations and Actions Regarding For-Profit Colleges](#)" (updated March 17, 2021).

¹⁰ California Dep't of Justice: "[Attorney General Xavier Becerra Sues For-Profit Ashford University For Defrauding and Deceiving Students](#)" (Nov. 29, 2017).

¹¹ As a general matter, HEA prohibits incentive-based payments to "any persons or entities engaged in any student recruiting or admission activities" 20 USC § 1094(a)(20). For nonprofits, uncapped revenue-share agreements can suggest an improper private benefit even outside of the recruiting, admissions, and financial aid functions.

¹² Department of Education data on file with the author and obtained by Yahoo! Finance through public records requests.

¹³ Unless otherwise noted, instructional expenditures referenced in this paragraph are calculated from institution-reported instructional expenses and net tuition and fee revenue on the 2017 Integrated Postsecondary Education Data System Finance Survey.

¹⁴ Specifically, Ashford's conversion to University of Arizona Global Campus includes a contract clause allowing a 2% maximum annual increase in the instructional portion of the school's operating expenses. Educational investments above that amount must come from the portion of the school's revenues that are left after Zovio has extracted a sizable fee, which could eliminate for over 70 percent of the school's tuition revenue. See generally <https://tcf.org/content/report/how-for-profits-masquerade-as-nonprofit-colleges/>.

increases to Zovio's recruitment expenses or revenue share fee. Last summer, Zovio hired an additional 200 sales agents¹⁵; meanwhile, accreditors expressed concern over Ashford's low number and compensation of full-time instructors.¹⁶

The same high-price, low-cost formula that spells profit for owners leads to dropouts, loan defaults, and worthless degrees for students.

- **Default Rates** - For-profit colleges enroll 8 percent of students, but account for 25 percent of student loan defaults.¹⁷ While the 13 percent default rate of the for-profit sector is already too high, in many cases, for-profit conversions produce student loan defaults at even higher rates. For example, **Bryant & Stratton College**, which is currently pursuing a for-profit conversion, has a 20 percent student default rate. Both **The Art Institute of Atlanta** and the **Art Institute of Houston**—two of the schools involved in the Dream Center conversions—had default rates over 20 percent.
- **Debt-to-Income Ratios (Gainful Employment)** - For-profit colleges represent 66 percent of the programs tested against the debt-to-earnings ratio in the 2014 Gainful Employment rule. However, for-profit programs disproportionately produced bad results, and accounted for 98 percent of programs that failed the gainful employment standard. Some predatory for-profit schools sought conversions as a way to avoid scrutiny for their failing programs; for example, when for-profit EDMC sought to convert **Argosy**, **Art Institute** and **South University** schools to nonprofit status, those chains included 137 programs that failed the gainful employment standards.¹⁸
- **Repayment rates** - Many student loan borrowers take years before they can begin paying down the principal of their student loans. After five years of repayment, on average, the majority of borrowers at public institutions (52%) and nearly two-thirds of borrowers at nonprofit institutions (64%) have reduced their original student loan principal by at least \$1.¹⁹ But, unfortunately, only 39 percent of borrowers who attended for-profit institutions are able to reduce their debt after five years of repayment; instead most students are either deeper in debt or in default. Repayment rates at for-profit conversions are even

¹⁵ Sarah Butrymowicz and Meredith Kolodner, "For-Profit Colleges, Long Troubled, See Surge Amid Pandemic," New York Times, June 17, 2020.

¹⁶ WASC Senior College and University Commission, *Commission Action Letter, Accreditation Visit, June 2019 action; Commission action letter, Initial Accreditation Visit, June 2012 action*.

¹⁷ Department of Education [Cohort Default Rate data](#) and [Integrated Postsecondary Education Data System data](#).

¹⁸ EDMC's failing programs include 13 at Argosy University, 15 at South University, and 109 at Art Institutes. <https://www.ed.gov/news/press-releases/education-department-releases-final-debt-earnings-rates-gainful-employment-programs>

¹⁹ Department of Education, College Scorecard: Repayment Rate data (2011-12 repayment cohort measured in 2016-17).

worse: only 23 percent of borrowers at **Bryant & Stratton College** and 16 percent of borrowers at **CollegeAmerica** are able to reduce their debt after five years of repayment.

Finally, when compared to genuine nonprofits, revenue-extracting schools are far more likely to precipitously close, leaving students educationally displaced. In 2019, The Chronicle of Education reported that for-profit schools are responsible for 85 percent of students harmed by campus closures.²⁰ Add in closures at revenue-extracting institutions like Alterius (the post-conversion form of Corinthian Colleges) and Dream Center (the post-conversion owner of Argosy, Art Institutes, and South University) and the body count is higher still.

Nonprofits close when they run out of resources to meet their educational mission. Resource-extracting institutions close when it serves their bottom line. When accreditors or regulators demand better outcomes from failing schools, owners can cut the cord and leave students stranded rather than go through the difficult and costly processes for either raising standards at the institution or securing an opportunity for students to make a smooth transition to another institution.²¹

As the GAO report noted, corrupt for-profit conversions facilitate revenue-extraction by insiders and weaken the financial viability of revenue-extracting institutions. GAO tracked 16 for-profit conversions that involved insiders; while all institutions were financially sound prior to the conversion, 15 of them failed key tests for financial soundness in the year following the conversion.²² In addition to harming students, these sudden closures carry a high cost for taxpayers. Shortly before Dream Center collapsed, its executive, Brent Richardson sent a letter to the Department of Education estimating that the collapse “would result in nearly \$1 Billion dollars in taxpayer liabilities.”²³ Richardson was also an insider whose family trust extracted resources from Dream Center schools, accelerating their collapse.

Revenue-extracting institutions post enormous risks for students and taxpayers, and they do not become safer merely because the IRS has become a less reliable gatekeeper. A distracted bouncer may let an armed criminal into a club, but that does not make the criminal safe. Instead, the Department of Education must look behind the IRS designations to ensure that institutions are regulated based on the risks they pose to students.

²⁰ Michael Vasquez and Dan Bauman, “How America’s College-Closure Crisis Leaves Families Devastated” (April 4, 2019).

²¹ Additional resources from The Century Foundation on precipitous college closures include: How to Stop Sudden College Closures (2019); [Reducing Harm from Sudden College Closures](#) (2020); To Monitor for Colleges That May Soon Fold, Look to Liquidity (2020).

²² GAO, [For-Profit College Conversions](#) at 26.

²³ U.S. House of Representatives Committee on Education and Labor: “SHATTERED DREAMS: EXAMINING THE EDUCATION DEPARTMENT’S ROLE IN THE MISCONDUCT OF DREAM CENTER EDUCATION HOLDINGS,” July 2020, at 1 (internal quotations omitted).

When the IRS misapplies tax-exempt status, it can go back and collect back taxes (with interest). But most students have just one shot at higher education. There are limits to the time, sacrifice, savings, student loan debt or military benefits a student can expend. If the Department of Education mischaracterizes a school, it leaves students unprotected and vulnerable to the worst abuses of for-profit schools.

Protecting Students from the Risks of Revenue-Extraction

The best way to protect students from the risks of revenue-extraction is to earmark every dollar for a specific, beneficial educational purpose. That is in effect what wealthy parents do each year when they send their children to nonprofit colleges; they protect their investment. At revenue-reinvesting nonprofits, board members owe a fiduciary duty to invest all of the institution's resources toward educational goals. But, insiders at for-profits and some putative "nonprofits" owe a fiduciary duty to shareholders, which is often misaligned with the educational needs of students. As a result, the entire patchwork system of for-profit regulation still fails to be as effective a defense as the affirmative mandate to reinvest all revenue in education.

Absent the revenue-reinvesting mandate, Congress has created a set of guardrails to temper the worst abuses of revenue-extracting schools. For-profit colleges sometimes describe sector-specific regulations as an unfair additional burden. This is disingenuous. Regulation of for-profit schools is a pale approximation of the resource reinvestment mandate that promotes student success at nonprofit institutions. To give an example, when for-profit owners have withdrawn or withheld investments to the point where a school is financially unstable, regulations require owners to report further withdrawals of capital.²⁴ This rule singles out for-profits for a simple reason—nonprofit owners are never permitted to withdraw capital. At false, revenue-extracting nonprofits, insiders can withdraw equity to the point of financial instability, and then they can keep going. It is no wonder that these conversions are prone to sudden closures.

The Department of Education grants private institutions two regulatory options: give up the revenue-extraction power and reinvest 100% of resources in students' education or retain the revenue-extraction power but abide by student protection guardrails. When predatory institutions want to keep their revenue-extraction power, divert resources from students' education, and evade student protection guardrails, they pursue disingenuous for-profit conversions. So far, as the GAO report has documented, many have gotten away with it.

This problem has been decades in the making, but the pattern is becoming clear. Congress legislates student protections, and the most predatory revenue-extracting institutions change their tax status to dodge them:

²⁴ 34 CFR 668.171(c)(1)(i)(B).

- After the Reagan administration sounded the alarm about for-profit schools where “semi-literate high school dropouts [were] lured to enroll in expensive training programs with false promises of lucrative jobs,” George H. W. Bush signed into law reforms that included the precursor to the 90/10 rule that this committee recently strengthened. Just before a prior iteration of the rule took effect, the owners of **Wright Career College** sought tax-exempt status from the IRS, openly declaring its desire to evade the new rules, and stating that “several other schools” had recently pursued the same tactic.²⁵
- As the Obama administration prepared to implement Gainful Employment regulations, which measured graduates’ earnings against their debt levels, the **Art Institute, Argosy and South University** schools (with over 100 programs failing the gainful employment standards) sought a conversion to nonprofit status. Argosy told its accreditor that the schools would be able to operate “in a much more cost efficient manner” if they were relieved on the 90/10 rule and treated as a nonprofit for purposes of the Gainful Employment regulations.²⁶ Additionally, this committee identified that the schools failed to meet accreditation standards for for-profit schools, and again, rather than improving their quality, they sought an end run by proclaiming themselves nonprofits.

Congress can no longer allow its rules to be side-stepped by the institutions that pose the greatest danger to students. If its protections are to be effective, the Department of Education must look behind IRS designations of tax-exempt status and scrutinize the resource-extraction power and practices of Title IV institutions.

The Danger of Deception

For predatory institutions, retaining revenue-extraction power while evading for-profit college oversight is already a neat trick. But there is a third, added benefit that makes disingenuous conversions even more enticing to predatory schools: the ability to market themselves to students as if they were truly charitable nonprofits.

After waves of fraud, abuse, and sudden closures in the for-profit sector, students have become wary of for-profit schools. That is why schools like Grand Canyon University brag to their shareholders about the stock-boosting benefits of advertising as a nonprofit.²⁷ Regulators should be wary any time shareholders are promised a payday from a conversion to nonprofit status: if an institution has truly abandoned its money-making goals, why would stock prices go up?

²⁵ The Century Foundation, *Was Wright Wrong? Early Warnings of Covert For-Profit Colleges* (2017).

²⁶ WASC Senior College and University Commission, Accreditation Team, Structural Change Cite Visit Report: Argosy University Change in Ownership, April 12, 2017 at 16

<https://drive.google.com/file/d/0B7adHdBE6w3mLUlwOHAYTnhEcW8/view?usp=sharing>

²⁷ <https://tcf.org/content/commentary/colleges-say-theyre-nonprofit/>

The basic formula of low tuition and high investment in educational resources serves students well. But it is not profitable. When revenue-extracting schools tout nonprofit status to potential students, they are benefiting from the trust that revenue-reinvesting institutions have built up by staying true to their educational mission. The reality is that share prices rise when shareholders know that they will continue to extract revenues, and expect that with the cloak of nonprofit status, students will be more willing to hand over tuition dollars.

Students intuitively believe that nonprofits will be safer than for-profit schools, but revenue-extracting for-profit conversions are, in fact, even more dangerous than for-profits that are subject to the appropriate regulations. For-profit conversions are not just wolves in sheep's clothing, they are wolves that have sharpened their teeth and honed their claws while the shepherd is busy chasing off the undisguised wolves.

If for-profit conversions continue, revenue-extracting nonprofits will put pressure on legitimate nonprofits and tarnish the reputation of the whole sector. Legitimate nonprofits will have to spend more on advertising to distinguish themselves and avoid losing students to predatory imposters. This type of advertising arms race would reduce trust and draw resources away from educational goals across sectors.

At the same time, if disingenuous conversions pay off for the current vanguard of revenue-extracting institutions, more for-profit conversions will surely follow. Eventually, the only for-profit schools that remain subject to for-profit regulations would be the ones too small, too unsophisticated, or too scrupulous to lawyer up and take advantage of the loophole.

The Tools of Revenue Extraction

The only constant in regulatory arbitrage is adaptation: even as GAO's report lays bare the various forms that questionable conversions have taken over recent years, predatory institutions are already innovating new arrangements for covert revenue extraction. The following examples are presented not as a comprehensive list, but to illustrate of creative variations on the revenue-extraction theme:

- **Revenue extraction through rent** - after these for-profit schools sought conversions to nonprofit status, **Keiser University** insiders continued to extract \$14.6 million a year in rent.²⁸ Likewise, insiders at **Center for Excellence in Higher Education (CEHE)**, who have since been found personally liable for knowingly defrauding students for Title IV funds, extracted \$5 million a year for rent.²⁹ Owners of **Bryant & Stratton College** are

²⁸ Unless otherwise indicated, additional detail on revenue-extraction mechanisms can be found at <https://tcf.org/content/commentary/colleges-say-theyre-nonprofit/>.

²⁹ The Century Foundation, [DeVos Must Take Action against Predatory College Chain](#) (Oct. 2020).

currently pursuing a conversion in which insiders would own the land through Prentice Realty Inc., and extract rent from the schools, which would be operated under the Prentice Family Foundation.³⁰

- **Revenue extraction through inflated loans** - The 2010 conversion of **Keiser University**, allowed insiders to continue extracting revenues through an inflated debt obligation. Keiser's original purchase price of \$610 million included \$543 million in tangibles (89%). The inflated purchase price transaction was financed by an insider loan; debt for questionable intangibles meant Keiser insiders could extract a continuous stream of revenue in the form of debt payments while offering the nonprofit nothing of real value. As revenue went out the door for debt payments, less was left for students.

Likewise, the **Herzing University** conversion also included an inflated purchase-price loan. The conversion generated an \$86 million (plus interest) debt held by insiders with intangible assets accounting for about half the value. But, just one year later, an independent evaluation placed the school's value at \$42 million, suggesting that the intangible assets were fictitious. Deeper debt means more aggressive revenue extraction and also more control for former owners.

- **Revenue extraction through services contracts** - After the for-profit conversion of **Grand Canyon University**, insiders and shareholders at Grand Canyon Enterprises (GCE) continued to extract resources from the school through an educational services contract which granted the GCE an uncapped portion of the institution's revenues. The Department of Education rejected Grand Canyon's application for nonprofit status, citing IRS precedent disfavoring uncapped revenue-share agreements.³¹ Similarly, the conversion of **Kaplan University** to Purdue University Global (PUG) allowed Kaplan's parent company, Graham Holdings Co., to extract resources through a long-term educational services contract that paid Graham Holdings a cut of any revenue it brought in through aggressive recruitment and marketing efforts that routinely tout PUG's "nonprofit" status.

The current efforts of for-profit **Ashford University** to convert to nonprofit status as University of Arizona Global Campus involve a long-term services contract that would allow Ashford's parent company, Zovio to extract upwards of 70% of students tuition dollars³² for services that could include a continuation of Ashford's predatory recruitment practices

³⁰ Emma Whitford, "Bryant & Stratton Pursues Nonprofit Conversion," Insider Higher Ed, (Dec. 4, 2020).

³¹ U.S. Dep't of Ed., [Letter to Grand Canyon University re: Change in Ownership and Nonprofit Status](#) (Nov. 2019).

³² <https://tcf.org/content/report/how-for-profits-masquerade-as-nonprofit-colleges/>.

The Department of Education Has the Tools To Regulate Revenue Extraction

It is a privilege and not a right for institutions to receive Title IV certification and obtain resources by placing students in debt to the federal government. When institutions can draw down federal funds on the one hand, and extract resources for insider enrichment on the other hand, there is a unique danger that very little will be left to serve the educational needs of low-income students. The students with the greatest need for educational investment will go into debt hoping to obtain that investment and leave revenue-extracting schools with little to show for it.

The Department already has the tools to protect students from the harms associated with revenue extraction: they are the guardrails and protections applied to for-profit schools. The Department does not define for-profit schools; that would create a roadmap for regulatory avoidance. Instead, any private school that fails to meet the Department's three-part test for nonprofit status—including any revenue-extracting institutions—is subject to stronger student protections.

Luckily, the Department of Education does not regulate based on tax status; rather, it uses IRS review as a shortcut to weed out some high-risk revenue-extracting schools. This worked well when for-profit colleges were smaller, more focused on education, and less invested in regulatory arbitrage. However, with predatory colleges increasingly manipulating gaps in IRS oversight, it is critical to remember that while IRS tax-exempt status is necessary, it is not sufficient to demonstrate nonprofit status for Department of Education purposes. Congress requires the Department to make its own determination as to which schools should be regulated revenue-extracting for-profits, and which should be regulated as revenue-reinvesting nonprofits.

**For-Profit College Conversions:
Examining Ways to Improve
Accountability and Prevent Fraud**

Testimony of Yan Cao



April 2021

1

Revenue Extraction - Resources Fail to Reach Students

"Congress has made an enduring investment in students' higher education. But not all of those resources reach the students who need them the most."



2

Revenue Extraction - The Profit Equation

What Students Pay



- What Students Get

"To understand why for-profit status matters, focus on the gap between the tuition dollars that students pay in and the educational investment that students get out of institutions."



3

Revenue Extraction - The Profit Equation

What Students Pay



Nonprofits
reinvest
resources



For-Profit
owners
extract
resources



What Students Get



4

Two Regulatory Options for Private Institutions



For-profit regulations are not added burdens—they are **guardrails** to protect students when institutions lack an **absolute barrier** against revenue extraction.

5

Two Regulatory Options for Private Institutions

“Private institutions have two choices: Either give up the revenue-extraction power and reinvest 100% of resources in students’ education OR retain the revenue-extraction power but abide by some student protection guardrails.”



6

The Danger of Deception

"For-profit conversions are not just wolves in sheeps' clothing, they are wolves that have sharpened their teeth and honed their claws while the shepherd is off minding other wolves."



Additional Resources from The Century Foundation:

- *The Covert For-Profit (2015)*
- *Was Wright Wrong? Early Warnings of Covert For-Profit Colleges (2017)*
- *Purdue University Global Is a For-Profit College Masquerading as a Public University (2018)*
- *These Colleges Say They're Nonprofit—But Are They? (2018, updated 2020)*
- *How For-Profits Masquerade as Nonprofit Colleges (2020)*
- *Dubious Conversions of For-Profit Colleges: Decoding the GAO Report (2021)*

**THE CENTURY
FOUNDATION**

Chairman SCOTT. Thank you. Now we'll hear from Mr. Galle.

STATEMENT OF BRIAN GALLE, JD, LL.M., PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER

Mr. GALLE. Thank you, Chairman Scott, and Members of the committee. My name is Brian Galle. I'm a Professor of Law at Georgetown. I'm here to discuss the efforts of a number of colleges which are operated for-profit, to get recognition from the education department as non-profit.

I'm going to call these efforts conversion transactions. I'll tell you why I think these conversions are so concerning for students and taxpayers. The IRS and ED both have jurisdiction over schools that claim to be non-profits, so I'll explain why I think IRS hasn't been able to address my concerns, and I'll tell you what I think ED should do.

First a little background. As you know, the Higher Education Act and ED's regulations treats schools differently if the school is operated for profit. The 90/10 Rule and gainful employment rules both regulate for-profits more carefully than other schools.

So, what's the difference between a for-profit and non-profit school? The answer is incentives. For-profits want to make money for their owners, non-profits can't. Legally being a non-profit means that an organization can't share its profits with anyone.

A for-profit school is like a car salesman who works on commission. When you walk in, they want to sell you all the expensive options you don't really need, like the fake wood trim. There's evidence this difference in incentive matters. Researchers find that for-profit colleges are actually a worse deal than dropping out of school for some students.

On average students at for-profits earn 11 percent less than similar students at non-profits or public schools, and they have more debt besides. Insured genuine non-profit status offers key protections for students. A traditional non-profit behaves differently than a school that's incentive to maximize revenue.

Now what's troubling about conversion transactions? You have a school saying it's a non-profit, but it isn't acting like one. We'd all agree a cancer charity that spends 80 percent of its revenues on fund-raising is not really a charity at all.

Some of these converted for-profit colleges are like that. Their non-profit status is a disguise. Here's your typical transaction. Mr. Investor sells the school that Charity Z which he also founded, in exchange for an 800-million-dollar IOU. Every year Charity Z has to pay him 50 million dollars or so in interest.

It's important to realize what that massive payment back to Mr. Investor means for the new non-profit school. Before the conversion School A has 50 million in net revenues, all of which it was paying to Mr. Investor. After the conversion, Charity Z still needs 50 million dollars in net revenue just to pay to Mr. Investor.

In short, Charity Z is a prisoner of its debts. To be able to pay it has to be continuing to operate the school exactly the way it was run before, to maximize net revenue. It's like if you wanted to retire but you have a big mortgage, so you're stuck working until you can pay it off.

The new non-profit's rule is in the exact same position. It's calling itself a non-profit, but it still has to act like a for-profit, maximizing its income, not student outcomes. By the way I didn't make up that transaction, it's the actual deal that Grand Canyon University made.

Other schools have also added huge debts to their for-profit partners too, 134 million, 321 million, 636 million. Look at, so what should education do about this? Title IV allows ED to decide when a school is a non-profit for purposes of the statute. As you probably know, that's also a determination IRS makes, based on similar language for purposes of figuring out whether an organization can be tax exempt.

As the GAO report tells us, the IRS hasn't closely examined a lot of these conversions, some of them it hasn't even known about. IRS hasn't actually flunked any of these organizations, but that doesn't

mean everything is fine. Instead, it should signal that education needs to conduct its own independent review.

Right now, education and IRS have what I call a centerfield problem. I was a youth baseball coach. Every time there's a flyball to centerfield, two of my kids would both yell, "I got it," and then the ball would fall right to the ground.

Education should be fielding the problem of for-profit conversions. IRS doesn't have the resources. Even if that agency got another billion dollars a year, there's still one and a half million charities for them to monitor every year.

IRS also doesn't have student protection as its primary mission. The law it enforces isn't aimed at telling which charities are really non-profit and which aren't. To be clear in my view a lot of the conversion transactions I examined failed basic and important tax law requirements.

But figuring out which schools prioritize money over student outcomes is not IRS's job. So that brings me to my conclusion. Education is the right agency to monitor for-profit conversions. Title IV is intended to impose tougher standards on schools that have a financial incentive to favor revenues over student outcomes.

Education can and should implement Title IV to make sure that that is true no matter whether some organizations might slip past IRS scrutiny. Thank you again for inviting me to testify. I'm happy to answer any questions you might have. I hope my comments are helpful to the committee.

[The prepared statement of Mr. Brian Galle follows:]

PREPARED STATEMENT OF BRIAN GALLE

Written Testimony of Brian Galle¹

Before the House Committee on Education and Labor

Hearing on *For-Profit College Conversions: Examining Ways to Improve Accountability and Prevent Fraud*

April 20, 2021

Thank you, Chairman Scott, and members of the Committee, for inviting me to speak today, and for holding this hearing. I am here to explain the importance of genuine non-profit status in higher education. As you know, in a number of recent transactions, colleges that were formerly for-profit, or in the statutory terminology, “proprietary” colleges,² have claimed that they became non-profit. In my view, a number of these transactions did not genuinely result in a new non-profit, either from a legal or economic perspective. As a result, students at these institutions are left vulnerable to exploitation and other poor outcomes, and all while believing that they are enrolled in a trustworthy, nonprofit, institution. The Education Department should ensure that organizations that have incentives to squeeze their students for profit are regulated that way.

Role of For-Profit Status in Education Department Regulations

Nonprofit status potentially affects key aspects of the Education Department’s (herein “Education” or “Ed”) regulatory regime for institutions of higher education. The first of these, sometimes called the “90/10” rule, relates to an institution’s sources of revenue. That rule is certainly in effect today, and will be further expanded under recent congressional amendments effective in 2023. The status of another provision, known as the “Gainful Employment” rule, is less certain, and is currently the subject of litigation. Nonprofit status affects an institution’s treatment under both these requirements.

The 90/10 rule effectively bars affected institutions from depending too heavily on federal financial support. If a for-profit institution receives more than 90% of its revenues from sources receiving federal support under Title IV of the Higher Education Act for two consecutive years, that institution loses its eligibility to receive further such funds for at least two years.³ Title IV includes most of the major federal supports for higher education, including Pell Grants, Federal Work-Study, Direct Loans, and Perkins Loans. For purposes of this calculation, revenues are limited primarily to tuition and fees for essential student services.⁴

¹ Professor of Law, Georgetown University Law Center. Institutional affiliation provided for identification purposes only. The views of the author are not the views of Georgetown or any other person or entity.

² 20 U.S.C. § 1002(a)(1)(A).

³ 20 U.S.C. 1094(a)(24), d(2).

⁴ *Id.* § 1094(d)(1).

In addition, effective in 2023, revenue sources supported by any federal expenditure will fall into the restricted 90% category.⁵ In practice, this change prevents schools from using revenues from students receiving aid from the V.A. and U.S. Department of Defense to satisfy their 10% private-source requirement.

The Gainful Employment Rule similarly restricts access to Title IV funding for some for-profit institutions.⁶ In broad terms, the Rule requires certain institutions, primarily for-profits, to hit defined metrics for student earnings outcomes, such as the ratio of the graduates' earnings to student debt payments.⁷ Institutions that fail to reach these metrics consistently will be suspended from Title IV participation. Institutions must also disclose information about student success, including what the typical graduate earns, their typical debt, and what share of graduates find success in their field.⁸

Beginning in 2017, the Education Department sought repeatedly to delay, and then rescind, the Gainful Employment Rule. The Department delayed implementation of the disclosure requirements three times.⁹ In 2019, it sought to rescind the Rule entirely.¹⁰

The current status of the Gainful Employment Rule is unresolved. Following its issuance, the rescission rule was challenged by teachers, teachers' unions, and the State of California.¹¹ The District Court denied the Department's motion to dismiss, allowing plaintiffs to proceed on their claim that the Department failed adequately to justify its reversal.¹² That challenge is ongoing.¹³ I am unaware of any official statement from incoming Education Department officials regarding whether they intend to continue defending the rescission rule.

Why For-Profit Status Matters

Given the key role that for-profit status plays in current ED rules, it is worth understanding the ways in which nonprofit organizations differ from the for-profit firms that are more familiar to us from other industries. Technically, a nonprofit organization is one that has voluntarily agreed to be governed by state nonprofit law. Federal law also provides certain benefits, such as tax exemption, to nonprofit organizations that meet federal requirements.¹⁴ But this technical definition only scratches the surface. Why do organization founders choose to be bound by nonprofit law, and how does that choice shape their behavior?

⁵ America Rescue Plan Act of 2021, Pub. L. 117-2, § 2013.

⁶ Program Integrity: Gainful Employment, 79 Fed. Reg. 64890 (Oct. 31, 2014).

⁷ *Id.* at 64890-91.

⁸ *Id.*

⁹ *Am. Fed'n of Teachers v Devos*, 484 F. Supp. 3d 731, 739-40 (2020).

¹⁰ Program Integrity: Gainful Employment, 84 Fed. Reg. 31392 (Jul. 1, 2019).

¹¹ *Am. Fed'n of Teachers*, 484 F. Supp. 3d at 740-41.

¹² *Id.* at 749.

¹³ The last-docketed item recorded is an October, 2020 request to file a motion for reconsideration on behalf of Secretary Devos.

¹⁴ See, e.g., I.R.C. § 501(c)(3).

Nonprofit status is about trust. In many markets, buyers cannot easily verify the quality of the products on offer, and cannot know if the firm will exploit their ignorance. Think of an organization that promises that in exchange for a payment of \$1,000, they will vaccinate ten families in Africa against malaria. Purchasers of these vaccination services cannot know whether it actually costs \$1,000 to vaccinate ten families, or instead only \$100. Often, the purchaser cannot even know if the services are delivered at all. Faced with this uncertainty, many customers would refuse to do business with the organization.

Education is a good example. It is difficult for prospective students to know in advance whether the education a school promises will be a good one; scholars would say that going to school is an "experience good" whose value you have to live to assess. Even after graduating, it can be hard to know whether the educator gave you a high-quality experience, unless you are an expert at evaluating pedagogical techniques. You can tell if the dorm was falling down, but you don't know if the curriculum and professors really prepared you for a career.

Adopting nonprofit status helps to overcome this credibility dilemma. Under state law, a nonprofit cannot pay out profits, but must instead reinvest any excess revenues into its charitable mission. Similarly, under federal tax law, an organization can escape from the corporate income tax if it commits itself not to share its profits with any private party. These commitments help to reassure customers that the organization will not exploit them. If there are investors demanding payment, the organization has reason to take \$1,000 and deliver only \$100 worth of vaccine. But a nonprofit that deprived its customers of \$900 in this way would only be able to spend the \$900 on more vaccine.

Put another way, genuine nonprofit status fundamentally transforms the incentives of an organization's managers by removing the profit incentive. At a traditional, for-profit business, managers have a legal obligation, known as a fiduciary duty, to maximize the interests of the business's owners. Turning a profit is almost always one of the central tasks, and some scholars say the only permissible task, for these managers.

To be sure, there are some business owners that want to pursue goals other than profit, but even at these firms there is still pressure on managers to deliver the bottom line. Businesses that could turn a healthy profit but do not will often be bought by investors who see the opportunity to gain from turning around an under-performing asset. Usually the first step the new owner takes is to fire the old managers. Managers therefore have strong personal reasons to heavily emphasize profit, no matter the preferences of the current business owners.

In contrast, state law prohibits (and federal law disincentivizes) nonprofit managers from considering profit. Again, there is no point in maximizing profit at a nonprofit, since net revenues have to be reinvested in the firm. But state law goes further, holding that managers have a fiduciary duty to uphold and pursue the charitable mission of the organization. The organization of course must break even, and can aim to gather enough resources to expand its mission. But managers must not base decisions on whether their choices will make money, but instead on what best serves the organization's mission.

Consistent with this theory, numerous studies, across many industries, find that genuine nonprofit status protects consumers, and results in higher-quality services. Compared to nonprofit and public schools, for-profit colleges offer "high costs and low

returns.¹⁵ Costs exceed benefits for many for-profit enrollees.¹⁶ Graduates earn 11% less, on average, than similar students who go to public schools.¹⁷ Some students would do better to drop out of community college than to transfer to a for-profit college.¹⁸

There are similar differences in health care. Studies using modern econometric methods find that non-profit nursing homes are higher quality, with fewer bed sores, falls, or other negative outcomes.¹⁹ Although measures of hospital quality are controversial, researchers generally agree that nonprofit hospitals do not mark up costs as aggressively as for-profits, and do a better job of protecting the most vulnerable patients.²⁰

Consumers also see better results when the profit motive is weaker at financial services firms. For-profit insurance companies with traditional stock ownership have 20-25% more delayed payments and misconduct than mutual insurers, who like nonprofits cannot distribute profits to investors.²¹ Similarly, credit unions, a form of customer-owned mutual bank, behave quite differently from typical commercial banks.²² Most commercial banks earn large fractions of their banking income through fees and charges that customers could avoid if the customer were highly attentive and able to carefully manage their account usage; overdraft fees and late charges are common examples.²³ Credit unions, in contrast, often advertise that they offer “no hidden fees,” and then in fact deliver on that promise.²⁴

For-profits maximize revenue, not quality. For-profit hospice care organizations stretch out patient stays to maximize revenue.²⁵ For-profit colleges respond to changes in

¹⁵ Luis Armona et al., “Student Debt and Default: The Role of For-Profit Colleges,” *Federal Reserve Bank of NY Staff Report* No. 811 (Feb. 2020), https://papers.ssrn.com/Sol3/papers.cfm?abstract_id=2958120.

¹⁶ Stephanie Riegg Cellini & Nicholas Turner, “Gainfully Employed? Assessing the Employment and Earnings of For-Profit College Students Using Administrative Data,” *54 J. Hum. Resources* 342 (2019).

¹⁷ *Id.*

¹⁸ Vivian Y.T. Liu & Clive Belfield, “The Labor Market Returns to For-Profit Higher Education: Evidence for Transfer Students,” *48 Community College Review* 133 (2020).

¹⁹ *E.g.*, Lisa A. Ronald et al., “Observational Evidence of For-Profit Delivery and Inferior Nursing Home Care: When Is There Enough Evidence for Policy Change?,” *PLoS Medicine* (Apr. 16, 2016), <https://journals.plos.org/plosmedicine/article?id=10.1371/journal.pmed.1001995>; David C. Grabowski et al., “Effect of nursing home ownership on the quality of post-acute care: An instrumental variables approach,” *32 J. Health Econ.* 12 (2013); Michael P. Hillmer et al., “Nursing Home Profit Status and Quality of Care: Is There Any Evidence of an Association?,” *62 Medical Care Research and Review* 139 (2005).

²⁰ Mark Schlesinger & Bradford H. Gray, “How Nonprofits Matter in American Medicine, and What to Do About It,” *Health Affairs Web Exclusive* (2006), <https://doi.org/10.1377/hlthaff.25.w287>.

²¹ Jiang Cheng et al., “The Ownership Complaint Gap: Mutual versus Stock Intermediaries,” *55 J. Financial & Quantitative Analysis* 1685 (2019).

²² Ryan Bubb & Alex Kaufman, “Consumer biases and mutual ownership,” *105 J. Pub. Econ.* 39 (2013).

²³ *Id.*

²⁴ *Id.*

²⁵ Richard C. Lindrooth & Burton A. Weisbrod, “Do religious nonprofit and for-profit organizations respond differently to financial incentives? The hospice industry,” *26 J. Health Econ.* 342 (2007).

the generosity of federal student-loan supports by hiking tuition, so that government aid is captured by investors, not students; there is no evidence legitimate non-profits do so.²⁶ Likewise, for-profit schools, and only for-profit schools, responded to increases in unsubsidized loan caps with tuition hikes.²⁷

The evidence is especially stark for one kind of for-profit investor: the private-equity firm. Private equity owners deliver especially high costs and poor outcomes. Following a private-equity acquisition, a college is much more likely to maximize its revenue from government sources, while at the same time seeing drops in graduation rates, loan repayment rates, and job placement.²⁸ A school that has “converted” but still is in partnership with a for-profit entity is at risk that a private equity firm will acquire its partner, and demand even more aggressive efforts to extract revenue

Why are for-profit firms able to thrive in these industries, when nonprofits deliver higher-quality products? In part, because not all consumers understand that they are vulnerable to being exploited, and so do not recognize that a firm’s nonprofit status is important. For example, one pair of researchers argues that many borrowers do not recognize that banks will employ hidden fees and charges.²⁹ These are the consumers who prefer commercial banks. Only the relatively smaller group of more sophisticated borrowers recognize that credit unions are the safer option.

Students’ Interest in Nonprofit Status of an Institution

Genuine nonprofit status therefore offers important protections and assurances for students. A traditional nonprofit behaves differently than a school that is incentivized to maximize revenue. Students and their families cannot realistically be expected to carefully review the ownership structure and contracts a school has entered into to verify whether the school has the incentives to deliver a high-quality experience. They can only rely on Ed’s designation that the school is nonprofit.

In addition, the nonprofit triggers in both the 90/10 Rule and the Gainful Employment rule protect important student interests. The 90/10 Rule uses market pressure to incentivize institutions to deliver quality educational services.³⁰ In effect, the Rule obliges schools to attract some students who must pay out of pocket for tuition and fees.³¹ It

²⁶ Stephanie Riegg Cellini & Claudia Goldin, “Does Federal Student Aid Raise Tuition? New Evidence on For-Profit Colleges,” 6 *Am. Econ. J. Econ. Pol’y* 174 (2014).

²⁷ David O. Luca et al., “Credit Supply and the Rise in College Tuition: Evidence from the Expansion in Federal Student Loan Programs,” 32 *Rev. Fin. Studies* 422, 453 (2019).

²⁸ Charlie Eaton et al., “When Investor Incentives and Consumer Interests Diverge: Private Equity in Higher Education,” 33 *Rev. Fin. Studies* 4024 (2020).

²⁹ Bubb & Kaufman, *supra*.

³⁰ James D. Ward, “Intended and Unintended Consequences of For-Profit College Education: Examining the 90/10 Rule,” 48 *J. Student Fin. Aid* 1, 5 (2019).

³¹ Vivien Lee & Adam Looney, “Understanding the 90/10 Rule,” Brookings Institution, Jan. 2019, at 3.

therefore “induce[s] institutions to offer worthwhile programs that provide benefits to students large enough that students are willing to contribute their own funds.”³²

The Gainful Employment Rule, if applicable, would provide several additional protections for current and prospective students. Most directly, its disclosure provisions would allow students to make more informed decisions about whether to enroll or continue enrollment at a given school. Additionally, by tying the institution’s ongoing financial viability to its graduate’s ability to repay their debts, the Rule incentivizes schools to invest in high-quality programs that prepare graduates to succeed, to mitigate the graduates’ debt levels, or both.

For-Profits in Disguise: Recent “Conversion” Transactions

The GAO Report describes several different ways in which formerly proprietary institutions have attempted to obtain legal recognition as non-profits instead.³³ I believe many of these transactions leave the institutions as non-profits in name only. Although the institution may even succeed in obtaining recognition from the IRS as a charitable organization, as a matter of economic reality, the school and its managers are still strongly motivated to maximize revenue, not student outcomes. The fundamental purpose of the nonprofit form, as I have explained, is to encourage potential customers and supporters to trust that the organization will not divert their money to the benefit of the organization’s insiders. These transactions instead exploit and betray that trust, following a playbook familiar from credit counseling agencies two decades ago.

In my view, many of the new “nonprofit” organizations in these transactions are still essentially for-profit—in the sense that they still prioritize profits, not student outcomes—because they are prisoners of their debts to their for-profit partners. When Everglades College was sold, it owed \$321 million to Art Keiser, its Chancellor. Remington Colleges initially owed \$134 million to its predecessor for-profit. The Center for Excellence in Higher Education, a collection of proprietary institutions, was sold to a non-profit controlled by the proprietary owner for a promissory note with a valuation of \$636 million. Grand Canyon University owes \$800 million to its predecessor and for-profit service provider, now known as GCE.

There is no way for these institutions to behave other than exactly like the for-profit schools they have always been. Debts this massive force them to constantly scramble for dollars at the expense of educational quality. In almost all these deals, a large fraction of the sale price is based on the “intangible” assets of the proprietary institution, which in turn are valued based largely on a multiple of the institution’s historic revenues.³⁴ Almost by definition, then, the debts can only be sustained if the organization keeps earning profits at

³² Ward, *supra*, at 5.

³³ GAO-21-89, *IRS And Education Could Better Address Risks Associated with Some For-Profit College Conversions* (Dec. 2020) (“GAO Report”).

³⁴ GAO Report at 29.

the same rate it was before the “conversion,” which is to say, it must keep acting as a for-profit would.

A credit agreement and the threat of bankruptcy, which would eliminate an institution’s eligibility to receive federal aid, can leave a newly converted “non-profit” with very little flexibility to prioritize students over revenues. Any flexibility that remains is unlikely to be used because it is the creditor who also controls the institution. Effectively, the former owner can continue to siphon out profits from the “non-profit” institution via the debt obligation. Ed estimated, for instance, that taking debt and service-contract payments into account Grand Canyon University would pay an astonishing 95% of its annual revenue to GCE.³⁵ Education has recognized that debt arrangements based explicitly on net profit can raise this danger, and for that reason declined to recognize the Center for Excellence in Higher Education as a nonprofit.³⁶

More generally, though, every highly-leveraged debt of this kind is in financial reality based on net profits. With relatively few liquid assets relative to the size of its obligations, the school can only pay its debts to the extent that its other operations produce sufficient cash. In other words, the school’s real asset is its ability to continue to draw down federal financial aid benefits in the same aggressive way that it did as a for-profit. As finance experts have long understood, these sorts of arrangement where debt greatly exceeds available hard assets are economically indistinguishable from equity, or profit-based, investment.³⁷

Loans aside, there is also a serious danger the non-profit form is not genuine when the new “non-profit” is led by individuals who still stand to profit from its operations. GAO described several of these transactions. GAO Report at 22-23. In most of them, the proprietary institution’s assets are sold to an organization that already has obtained nonprofit status from the IRS, in some cases an organization that was established by the same individuals who are operating the proprietary institution. The for-profit sellers then take over in positions of leadership at the non-profit, and of course are paid for that service. More importantly, the terms of the sale allow for large ongoing payments from the non-profit to the sellers, usually through leases or service contracts.

It is very difficult to be confident that arrangements like that are fair to the nonprofit, its students, or taxpayers who support them. The managers of the new “non-profit” have obvious incentives to manage the organization so that it lines their own pockets. Even if a top manager nominally recuses herself from certain decisions, as some organizations told GAO,³⁸ her subordinates are perfectly aware that their choices will personally affect her. As nonprofit law has long recognized, a manager who is in a position

³⁵ Letter from Michael Frola, Director, Multi-Regional and Foreign Schools Participation Division, U.S. Department of Education, to Brian Mueller, President, Grand Canyon University, at 14 (Nov. 6, 2019).

³⁶ <https://www2.ed.gov/documents/press-releases/08112016-cio-decision.pdf>

³⁷ Myron Scholes et al., *Taxes and Business Strategy: A Planning Approach* 355–37 (5th ed. 2016).

³⁸ GAO Report at 24.

to reward board members or subordinates for their loyalty can steer outcomes in her favor even if she doesn't make those decisions herself.³⁹

To be sure, not every payment from a nonprofit to its insiders is problematic. Managers can and should be paid a fair wage. What distinguishes these deals is their magnitude, their opacity, and their potential for abuse. Salaries can certainly become excessive, and can affect managers' decisions, as my research has suggested.⁴⁰ Still, there is typically only an indirect connection between how a college president runs the organization and her compensation, and her decisions are unlikely to change her pay by more than a few hundred thousand dollars. Raising tuition, aggressive recruiting, and slashing instructional costs will not double her pay. In contrast, these deals involve ongoing payments of millions and tens of millions of dollars to the insiders.

The magnitude of the managers' incentives, and the difficulty of policing them, merits much more careful oversight. It is largely in the hands of the insiders whether to enter into those arrangements, and then to continue them. Ascertaining the fair value of unique assets, such as a campus, is difficult, and so it is hard for any outside party to assess whether the insider is using their influence to extract unwarranted payments. Further compounding this problem, an institution does not need to lease its buildings from its insiders; it can rent somewhere else, buy property, or pursue an on-line business model. Even if the rental payments are not inflated, that fact tells us nothing about whether the organization would have been better served to pursue one of its other alternatives to renting from the insider. It is inherently difficult for an IRS auditor or other regulator to review all the factors that an organization might consider when making these kinds of strategic decisions. This gives self-interested managers a free hand to prioritize their own wealth. Certainly not all will do so. But the greatly heightened risk that they can and will is what justifies close scrutiny.

Indeed, for this reason tax law typically presumes that arrangements of this kind are inherently non-charitable. When a charity puts the daily management of a substantial share of its assets or operations in the hands of for-profit service providers, the charity must retain "control" over the venture.⁴¹ If instead the for-profit interests can determine how the operations are managed, tax law assumes that those operations will not be charitable in nature. If the for-profit's insiders also exert significant influence over the charity, the IRS is likely to conclude the charity does not "control" the venture.⁴²

The conversion transactions in fact follow a very similar pattern to the credit counseling agencies that in the early 2000s IRS, and ultimately Congress, concluded were

³⁹ Board of Regents of the University of the State of New York, *The Committee to Save Adelphi v. Diamandopoulos* 34 (1997).

⁴⁰ Brian Galle & David I. Walker, "Donor Reaction to Salient Disclosures of Nonprofit Executive Pay: A Regression-Discontinuity Approach," 45 *Nonprofit & Voluntary Sector Q.* 787 (2015).

⁴¹ Rev. Rul. 98-15 Sit. 2; see *St. David's Health Care Sys., Inc. v. United States*, 349 F.3d 232, 237 (5th Cir. 2003).

⁴² Rev. Rul. 98-15 Sit. 2.

not really nonprofits.⁴³ Credit counseling agencies were organizations that purported to help individuals manage their debts. In fact, their business model was to take payments from large creditors in exchange for extracting more payments from the counseled creditors, usually with the help of very aggressive marketing.⁴⁴ Applicable regulations were more demanding for counseling organizations that operated as for-profits. Many therefore attempted to reincorporate as non-profits. The new “non-profit” shared common control with a for-profit entity, and the “non-profit” counseling agency would be obligated to make a stream of interest or lease payments to the for-profit.⁴⁵ As IRS Chief Counsel concluded, although these arrangements may have superficially satisfied some of the formal requirements for tax-exempt status, they in fact were not charitable; they existed in order to enrich the for-profit investors, as well as their bank clients.⁴⁶ Much of that same analysis could be applied equally to for-profit colleges.

Despite all these evident shortcomings, most of the described transactions appear to have succeeded in obtaining IRS recognition as nonprofits. IRS enforcement actions are confidential.⁴⁷ GAO reports that about a third of the transactions it reviewed were audited by the IRS.⁴⁸ Most of the organizations described in the GAO report and still in operation today continue to regularly file tax returns, and these documents are public.⁴⁹ It thus appears that these organizations remain nonprofits for tax law purposes. I will now explore some possible explanations for this state of affairs.

Independent Review by Education is Necessary

Taken together, the GAO report and the transactions I have described suggest that IRS oversight is not sufficient to safeguard the interests of students or the general public in maintaining the genuinely nonprofit character of supposed nonprofit schools. In part, this shortcoming is due to resource and other institutional limits inside IRS. More fundamentally, though, the legal framework IRS employs isn’t designed to implement Title IV, and fails to further Title IV goals in certain key respects. Relying exclusively on IRS oversight would therefore mean that Ed is failing in its mission.

The GAO carefully and in my view accurately describes many of the procedural limitations at IRS that sharply constrain that agency’s ability to detect and investigate for-profits in disguise. Among other issues, IRS lacks resources to give any meaningful attention to most of the 1.5 million active U.S. charities. This resource crunch has worsened in recent years. For example, on an annual basis, IRS now denies less than 10% the number

⁴³ I.R.C. § 501(q); see *Profiteering in a Nonprofit Industry: Abusive Practices in Credit Counseling*, Sen. Rep. 109-55 (Apr. 13, 2005); IRS Chief Counsel Advisory 200431023 (July 30, 2004).

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.*

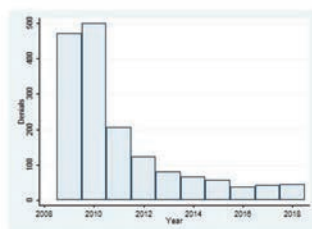
⁴⁷ I.R.C. § 6103.

⁴⁸ GAO Report, at 35 n. 72.

⁴⁹ I.R.C. § 6104.

of applications for tax-exempt status as it did a decade ago, even as total applications are up.⁵⁰

Figure One: IRS Denials of Applications for Exempt Status



Source: Author calculations, based on IRS Statistics of Income Data

The current administration is proposing to increase the IRS budget, but that will not solve other key gaps in IRS authority. For example, IRS asks taxpayers to identify transactions with “interested persons” on their tax returns, and defines that term to include “disqualified persons.”⁵¹ But it is left to the taxpayer in the first instance to decide which persons or entities are “disqualified persons.” An organization can therefore take an aggressive position with respect to which transactions even need to be reported. It has been reported, for instance, that Purdue Global did not report Kaplan Education as one of its five largest contractors, despite over \$45 million in contracts between the two organizations.⁵²

The uncertain state of tax law also leaves room for institutions to omit key information. For example, if a contractor is in a position to potentially exert significant influence over the conduct of a core operation of the school, but that contractor is not owned by an individual with a formal position of authority at the school, the applicable regulations would call for a complex balancing test to determine whether transactions with the contractor are reportable.⁵³ IRS is not typically able to second-guess the organization’s position, because without additional information outside the tax return IRS does not even know that the transaction took place. I therefore agree with the GAO report that it is advisable for IRS to ask specifically about conversion transactions.⁵⁴

⁵⁰ <https://www.irs.gov/statistics/soi-tax-stats-closures-of-applications-for-tax-exempt-status-irs-data-book-table-12>

⁵¹ IRS Form 990 Schedule L Instructions.

⁵² <https://tcf.org/content/commentary/purdue-global-got-irs-stamp-approval/>

⁵³ Treas. Reg. 53.4958-3(c), (d), (e).

⁵⁴ GAO Report at 49.

More fundamentally, resources and improved questions alone will not make IRS an effective monitor of for-profit colleges because that is not the task for which federal tax law, and IRS's regulations implementing it, were designed. As I have described, Title IV requires that Education be able to identify organizations that have a financial incentive to prioritize revenue over student outcomes, and ensure that these organizations are subject to more demanding regulations intended to protect vulnerable students. This is effectively a binary decision: the heightened regulatory standards either apply, or they do not.

For all intents and purposes, IRS does not apply a binary standard to charities it reviews. Instead, when IRS detects a diversion of organizational resources to an impermissible private purpose, IRS imposes a penalty tax on the recipient and potentially the authorizing board members under its "intermediate sanctions" regime.⁵⁵ Congress enacted this regime because IRS has been extremely reluctant to revoke an organization's tax-exempt status.⁵⁶ The implementing regulations further cement this reluctance, stating that an organization where intermediate sanctions are applied will not typically lose exemption unless the violations were substantial in relation to the overall size of the organization's activities, they happened many times, and the organization failed to correct them.⁵⁷

In some transactions, IRS will not provide any scrutiny at all. Remarkably, IRS guidance entirely exempts "initial contracts" between a charity and a potential insider from penalties even under the intermediate sanctions regime.⁵⁸ Regulations expressly state that a management contract between an organization and an outside management company can fall into this exception.⁵⁹ Thus, a long-term contract between an educational institution and a for-profit service provider would not result in IRS enforcement, even if that contract provided for payments of essentially all the net revenues of the institution, as long as the parties were following the terms of their initial agreement.

Federal tax law also does not yet fully account for the power that an organization's creditors can exert over the institution. Practically speaking, in many cases a creditor can be as powerful as any officer of the organization, if not more so. If an organization cannot meet its debts, it is only the creditor's forbearance, on conditions negotiated between creditor and the organization, that can prevent the organization from dissolving. While charities usually cannot be forced into an involuntary bankruptcy proceeding, there are many other state-law collection mechanisms that can result in at least partial loss of control over the organization's assets.⁶⁰ Even if an organization avoids bankruptcy, failure to pay creditors may foreclose it from further access to affordable credit, effectively

⁵⁵ I.R.C. § 4958.

⁵⁶ James J. Fishman et al., *Nonprofit Organizations: Cases and Materials* 417 (5th ed. 2015) ("Historically, the Service has invoked the inurement limitation only in the most egregious of insider misconduct. Since the only sanction was the ultimate death sentence...enforcement was lax.")

⁵⁷ Treas. Reg. 1.501(c)(3)-1(f)(2)(ii), (iv) Ex. 3.

⁵⁸ Treas. Reg. 53.4958-4(a)(3).

⁵⁹ Treas. Reg. 53.4958-4(a)(3)(vii) Ex. 7.

⁶⁰ American Law Institute, *Restatement of the Law of Charitable Organizations* § 3.05 (Tentative Draft 2017).

shuttering its operations. The charitable institution's managers therefore have very strong incentives to meet their debts or to accede to other concessions demanded by unpaid creditors. This is especially so, of course, in cases such as those I have already described in which the institution's hundreds of millions of dollars in debt exceed by many multiples the value of its liquid assets.

Although creditors could therefore readily qualify as insiders, IRS guidance does not expressly recognize them as such. The intermediate sanction regulations provide that any person or entity that exerts "substantial influence over the affairs of [the] organization" can be treated as an insider for legal purposes.⁶¹ I have not been able to identify, however, any examples in which IRS has treated a person or entity as an insider solely on the basis of their creditor relationship to a charity.⁶²

In sum, it is not surprising that IRS has failed to effectively police for-profit colleges in disguise. Tax law is not currently designed to make bright-line distinctions between for-profit and non-profit entities. Even the more limited rules aimed at penalizing excess benefits for insiders have important holes that conversion planners have exploited. Verifying the details of large, complex transactions, investigating the details of the parties' relationships, and ascertaining the true values of assets being transferred are all time and resource intensive tasks, and IRS is an agency in which both of those are in very short supply.

Given the importance of a school's genuine nonprofit status to students and taxpayers, however, Education cannot be content to live with the inadequate review IRS provides. Title IV gives Ed independent authority to distinguish between a "proprietary" institution and one that is a "public or other nonprofit" institution.⁶³ Nothing in the statute requires Education to accept IRS review (or lack of it) as the final word on that question. Ed has the statutory authority it needs right now, and should independently assess whether educational institutions have powerful motives to maximize revenues at the expense of the student experience.

Both Education and IRS could additionally benefit from more extensive information sharing. It does appear that Education copied IRS on its findings in the Grand Canyon University matter. Formal agreements for sharing of information, expertise, and findings would allow for better coordinated policy. Federal law is currently an obstacle to full coordination. Although tax returns filed by federally-recognized charities are public, IRS takes the position that it is prohibited from sharing other "return information," such as the outcomes or even existence of audit activity.⁶⁴ Amending this provision would help

⁶¹ Treas. Reg. 53.4958-3(a)(1), (e)(2).

⁶² Even if creditors are not formally insiders, federal tax law may still prohibit excess benefits to them. A charity may not private an excess private benefit to any party, whether insider or not. [private benefit regs cite] But the law regarding prohibited benefits to parties that are not formally insiders is much less developed, leaving substantial room for creative transactional planning.

⁶³ 20 U.S.C. § 1001(a)(4), 1002(a)(1)(A).

⁶⁴ I.R.C. § 6103(j)(13) permits IRS to share tax-return information with Education for purposes of verifying a student's eligibility for subsidized student loans, but this authority arguably does not include sharing information about the institution the student attends.

Education to more fully understand whether IRS has undertaken enforcement with respect to a conversion transaction, and if not why not.

Disclosure is Likely Inadequate to Protect Student and Taxpayer Interests

It might be argued that Education review is unnecessary because students can rely on public information about school costs and outcomes, and can make their own decisions about whether to attend a converted for-profit school or not. In addition to their substantive requirements, the Gainful Employment regulations may include provisions requiring institutions to report on key cost and outcome measures.⁶⁵ Although these disclosure obligations could be useful to some students, they cannot substitute for the 90/10 rule or other components of the Gainful Employment regulations. Education therefore must continue to distinguish carefully between genuine nonprofits and others.

Data disclosures are useful primarily for families with the experience and savvy to find them, interpret them, and use them to compare institutions to each other. Many students in the community that historically have been disproportionately represented at for-profit colleges will struggle with some or all of these tasks. Researchers find, for example, that low-income households, and especially students who are the first in their families to attend college, are rarely able to comparison shop between schools to understand competing financial aid offers.⁶⁶ It is likely that many mistake the “sticker” price of tuition for the real price of attending school, not understanding that most schools provide financial aid or access to government-subsidized borrowing.⁶⁷

It is also uncertain whether disclosure requirements are meaningful in an environment with pervasive advertising. Many proprietary schools spend millions of dollars annually on advertising and recruitment.⁶⁸ Studies suggest that for-profit recruiters apply a variety of high-pressure sales techniques to enroll students.⁶⁹ It is unlikely that students will be attentive to numbers hidden deep in the school’s web site when they are continually exposed to these competing information sources.

⁶⁵ The legal status of the disclosure rules is presently uncertain, with Devoes-era changes still potentially subject to challenge.

⁶⁶ A helpful overview is Susan M. Dynarski & Judith E. Scott-Clayton, “Complexity and Targeting in Student Financial Aid: A Quantitative Analysis,” 22 *Tax Pol’y & Econ.* 109 (2008); see also Susan M. Dynarski et al., “Closing the Gap: The effect of a targeted, tuition-free promise on college choices of high-achieving, low-income students,” NBER Discussion Paper No. 25349 (2018); Caroline Hoxby & Sarah Turner, “Expanding College Opportunities for High-Achieving, Low-Income Students,” Stanford Institute for Economic Policy Research Discussion Paper 12-014 (2013).

⁶⁷ See Celeste K. Carruthers & Jilleah G. Welch, “Not whether, but where? Pell grants and college choice,” 172 *J. Pub. Econ.* 1, 19 (2019).

⁶⁸ Alejandro Vazquez-Martinez & Michael Hansen, Brookings Blog, “For-profit colleges drastically outspend competing institutions on advertising” (May 19, 2020), <https://www.brookings.edu/blog/brown-center-chalkboard/2020/05/19/for-profit-colleges-advertising/>; Stephanie Rieg-Cellini & Latika Chaudhary, “Commercials for college? Advertising in higher education,” Brookings Institution Report, <https://www.brookings.edu/research/commercials-for-college-advertising-in-higher-education/> (May 19, 2020).

⁶⁹ U.S. Senate, Health, Education, Labor, and Pensions Committee, *For Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success* 49–71 (July 30, 2012).

In any event, even if disclosures were effective at informing many students of the poor outcomes at many for-profit institutions, they would still not protect the general interest of taxpayers. Again, proprietary institutions often maximize their government-subsidized revenues, increasing tuition when government subsidies are higher or more widely available. In effect, government is made to pay more for the same education. Subsidized students are relatively insensitive to these changes in price, and so disclosures about cost burdens would not likely affect enrollment decisions. In contrast, the 90/10 rule obliges schools to attract students who indeed are cost sensitive, limiting the schools' ability to hike tuition across the board.

Given these well-documented problems with existing disclosures, it is unrealistic to expect that adding yet more information for aspiring students to comprehend will improve their choices. Ed can and should require simple and uniform information reporting, so that families' task is easier. But that is not enough.

Conclusion

Thank you again for inviting me to testify today. I hope that my perspective on these issues helps the Committee as it thinks about the difficult problem of for-profit colleges.

Chairman SCOTT. Thank you. Mr. Gillen?

STATEMENT OF ANDREW GILLEN, PH.D., SENIOR POLICY ANALYST, TEXAS PUBLIC POLICY FOUNDATION

Mr. GILLEN. Thank you. And thank you to all the Members of the committee for inviting us to talk on this important topic. I first want to comment the Government Accountability Office for putting together a very useful and insightful report. I think it's done a great job on a sound basis for their discussion.

Having said that I do want to raise a couple issues that I think can benefit from further conversation and investigation. So, the first concerns the GAO's recommendation that the IRS add more questions about recent for-profit college conversions to non-profit to their annual filings.

This may be a good idea, it may not, but I think it really needs to be conducted and subjected to a cost benefit test. And I'm skeptical that it would pass such a cost benefit test, because the benefits are very small. The numbers of conversions per year are very, very small. The number of conversions that involve insiders are even smaller, so we're talking about one or two colleges per year where this would even be relevant.

And moreover, this information is already collected by the Department of Education, so this would be just a duplicative kind of data collection by the IRS. But the cost wouldn't necessarily be as negligible, and that's because the IRS would be required to collect this information from all sorts of universities, and maybe other charities as well.

And see you could potentially be asking 300,000 others non-profits about a question that only applies to one, maybe two of them. And so, this committee has a lot of experience with the FAFSA form, how over the years it accumulated into you know just a massive amount of questions.

And it took us a decade to figure out how to simplify it. And so, I'd like us to keep that in mind when we are encouraging the IRS

to add other requirements that are only relevant to a very, very small fraction of schools.

A second point that I'd like to bring up is it would be very useful for us to distinguish between the different types of insider benefit and proper insider benefit. The lumping them all together is not necessarily appropriate because some of them can be assessed at the time of transaction, and some of them need to be assessed at an ongoing basis and making that distinction would be very valuable.

Another issue I'd like to flag is the issue of regulatory arbitrage, and so there's a number of different policies and regulations that apply to for-profits, or that don't apply to non-profits that can raise kind of a wedge between the value of a school as a for-profit and the value of the school as a non-profit.

And so, we just need to be careful when we're kind of assessing whether a transaction is fair. The value can actually—the value of the school can actually change quite a bit, whether it's for-profit or non-profit. Some states are kind of increasing regulations of for-profits.

There are a set of regulations at the Federal level that only apply to for-profits as well. And so, this regulatory arbitrage could kind of skew some of the assessments if we aren't careful.

And then, the last point I want to make is really that the accountability system that we have for higher education, if we were able to improve that accountability system, that would really do a lot to take much of the improper benefit problem that we could see with some of these entire conversions off the table.

So, with a better—and there's really two reasons for this. So, the first is that if we have a better accountability system, it's easier to value an account. Right now, it's very difficult to value a college, and so it's relatively easier for a nefarious insider to arrange for an inflated estimate.

That would be much harder if the accountability system we had made it much more objective way to value the account. The second way that a better accountability system would improve higher education, and kind of limit any insider involvement problems is that it would really allow for us to escape what's going forward in Bowen's laws.

And we don't have time to go all the way into those laws, but one of the implications of Bowen's laws is that essentially higher education is going to see increase in expenditure over time. And if you're in that environment, insiders at non-profits even, can find it very easy to arrange for improper benefit.

And so, the for-profit versus non-profit conversion, that's not even the real issue. The real issue is non-profits themselves can find a very easy way to arrange for an improper benefit when we are stuck in this Bowen's Law world where we've got increasing spending over time.

Thank you for allowing me to testify and I'll pass on the time.
[The prepared statement of Mr. Andrew Gillen follows:]

PREPARED STATEMENT OF ANDREW GILLEN



Statement Before the House Committee on Education and Labor
On For-Profit College Conversions
Andrew Gillen, Ph.D.
4/20/2021

Chairman Scott, Ranking Member Foxx, and esteemed members of the committee, thank you for giving me the opportunity to testify on this important topic.

The recent Government Accountability Office report *IRS And Education Could Better Address Risks Associated with Some For-Profit College Conversions* provides valuable insight into issues regarding insider involvement when for-profit colleges undergo conversion into nonprofit colleges.

As the report notes, there is nothing inherently wrong with either converting from a for-profit college to a nonprofit college or with having insider involvement.

Valid reasons for converting from a for-profit college to a nonprofit college include allowing students to obtain eligibility for state financial aid grants, avoiding bias in perceptions of educational quality, and overcoming local resistance to expansion.

Insider involvement could occur when an individual is a decision-maker at both the buying and the selling institution. For example, if the college president of a for-profit college is also the president of the nonprofit purchasing the college, they would be considered an insider. The main benefit to insider involvement is the maintenance of institutional memory, stability, and continuity.

But while there is nothing inherently wrong with conversions, even when they involve insider involvement, the involvement of insiders does raise the potential issue of improper benefit, where insiders use their decision-making authority to benefit themselves. For example, an insider could agree to an inflated purchase price (as the purchaser) that would benefit the insider (as the seller).

Both the Internal Revenue Service (IRS), enforcing the Internal Revenue Code, and the Department of Education (ED), enforcing the Higher Education Act, forbid insiders from improperly benefiting from any nonprofit, including colleges that convert from for-profit to nonprofit. The GAO report examines recent conversions to probe IRS and ED enforcement of these prohibitions.

The report identified several areas where either the IRS or ED would benefit from additional information to inform their decisions. Two of the three GAO recommendations involve either establishing or consistently following existing procedures to determine if there is improper benefit. These recommendations are sensible, and both the IRS and ED have agreed to implement these recommendations.

To assist IRS, ED, GAO, and this committee, I wanted to raise several issues for further consideration.

First, the GAO recommends that the IRS collect additional information from nonprofits regarding any past for-profit ownership, but this recommendation is likely premature. A proper cost benefit test

should be conducted before implementing this recommendation. I am skeptical that this recommendation would pass such a cost benefit test. The benefits of this information collection would be negligible, while the costs would be non-negligible. All conversions are already required to inform and secure the approval of ED, so new collections by the IRS would be duplicative. In addition, there are very few conversion attempts each year. Over a nine-year period, there were only 20 conversion transactions, some of which involved multiple colleges. GAO estimates that insider involvement may be present in around one third of these. This means that most years will see 0 or 1 conversions involving insiders. Thus, adding questions to annual IRS filings could potentially entail asking for additional information from 300,000 nonprofit organizations when this information is only relevant for a handful of them and the necessary information is already collected by ED.

Second, GAO, IRS, and ED would all benefit from distinguishing among the types of improper benefits to insiders and when those potential benefits should be evaluated. The most common types of insider benefit are 1) paying an inflated purchase price, 2) borrowing from insiders to make the purchase with unfavorable loan terms, 3) leasing land from insiders at inflated prices, and 4) paying inflated prices for services from firms owned by insiders. The IRS and ED should not investigate all four types of improper benefit in the same manner. The sale price and the financing should be evaluated for improper benefit at the time of the transaction, and only at the time of the transaction. Analyzing the sale price or loan terms years later is inappropriate because after the transaction, too many factors could affect the value of a college for an ex-post analysis to yield reliable information about whether the transaction terms were fair at the time. In contrast, paying inflated prices for leases or services should be investigated both at the time of the transaction and on an ongoing basis. But paying inflated prices for leases or services to insiders is a danger at all nonprofits and should be monitored using the same procedures used for all other nonprofits. Thus, I disagree when the report implies that ED should extend its review "beyond the initial approval of nonprofit applications." The initial approval is the only time that improper benefit from sale and financing terms should be evaluated, whereas improper benefit from leasing and services should be evaluated for all nonprofit colleges on an ongoing basis. If extended reviews consistently expose improper benefit to insiders due to inflated prices for leasing and services, then that is an argument for enhancing data collection for all nonprofit colleges.

Third, ED is increasing student confusion. For a for-profit college to convert to a nonprofit college, it needs IRS approval to become a tax-exempt organization, and then to meet several additional requirements for ED to consider the organization a nonprofit college. These approvals can be years apart, resulting in a situation where a college is tax-exempt according to the IRS, but is not yet considered a nonprofit college by ED. Unfortunately, ED's proposed restrictions would forbid a college that has tax-exempt status from referring to itself as a "nonprofit institution" in the name of reducing confusion. Yet the vast majority of the general public, including potential students, likely associate the term tax-exempt with the term nonprofit, so this restriction may increase rather than decrease confusion. There is no clear solution since a tax-exempt (according to the IRS) but for-profit (according to ED) college should not exist in theory yet does in practice. But I am skeptical that outlawing truthful statements is the best approach.

Fourth, regulatory arbitrage is an underappreciated factor in conversions because the value of some colleges can be substantially increased by conversion. Recently, states such as California, New York, Maryland, Oregon, and Maine have moved to impose additional burdens on for-profit universities within their borders.¹ For-profit colleges with operations in these states, or colleges wishing to expand into these states would face fewer obstacles by undergoing a conversion into a nonprofit college. At the federal level, there are often additional regulations applied to for-profit universities. For example, the 90-10 rule limits the share of revenue that for-profits can obtain from the federal government. And the short-lived Gainful Employment regulations heavily targeted programs at for-profit universities. These additional regulations targeting for-profit universities can increase the appeal of conversions since the value of a nonprofit college not subject to these additional regulations may be substantially higher than the same college as a for-profit.

Fifth, a better accountability system would provide the best protection against insiders extracting improper benefits. If we had a comprehensive and transparent accountability system, it would be much harder for insiders to extract improper benefits for two reasons. One, with more and more precise metrics of outputs and outcomes, the value of any given college would be less reliant on subjective valuations, making it harder for insiders to benefit from an inflated sales price. Two, once colleges are competing based on better defined and measured outputs and outcomes, there would be constant pressure to eliminate improper insider dealing due to healthier competition among colleges. Because there is too little information on college outputs or outcomes, colleges are locked into the Revenue Theory of Costs, also known as Bowen's laws.² *Introducing Bennett Hypothesis 2.0*³ contains a more detailed explanation of Bowen's laws, but to briefly summarize, because college quality cannot be observed, colleges compete to increase prestige or perceived quality. There is no limit to activities that can increase prestige, so there is no limit to the revenue that colleges will seek. Whatever revenue they raise will be spent (hence the name revenue theory of costs), and the end result is that colleges are locked in a never ended academic arms race to spend as much money as possible in the pursuit of prestige. This has absolutely devastating consequences for important issues like college affordability. But it also means that it is relatively easy for insiders to hide excessive spending.

Improving the accountability system could free higher education from Bowen's laws. Fortunately, ED has recently started releasing data that could truly revolutionize higher education accountability. Specifically, ED's College Scorecard dataset contains program level (e.g., the bachelor's in political science program at Ohio State University would be one program) data on student loan debt and post-graduation earnings for recent college graduates. This would allow for two dramatic improvements in our approach to college accountability.

The first improvement is to facilitate a transition from an institution (college wide) accountability framework to a program level accountability framework. The existing institution framework applies

¹ See for example Ashley A. Smith, States Seek Tighter Regulation of For-Profits, Inside Higher Ed, March 14, 2019, <https://www.insidehighered.com/news/2019/03/14/bills-california-and-several-other-states-would-tighten-regulation-profit-colleges>

² Howard R. Bowen, *The Costs of Higher Education*, Jossey-Bass Publishers, 1980.

³ Andrew Gillen, *Introducing Bennett Hypothesis 2.0*, Center for College Affordability and Productivity, 2012.

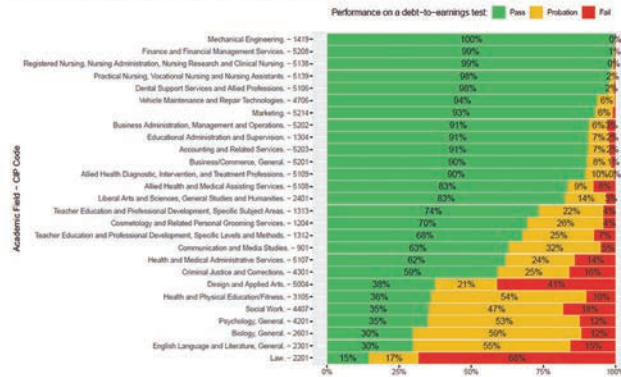
accountability mechanisms such as accreditation and Cohort Default Rates to entire institutions. But an institution wide approach punishes good programs at “bad” colleges while letting bad programs at “good” colleges off the hook. A program level accountability system would avoid both issues.

The second improvement is the ability to hold colleges accountable for the labor market outcomes of their graduates. Programs that consistently leave students with excessive student loan debt that they cannot afford to repay should be held accountable.

My organization has been using the College Scorecard data to enable policymakers to design new program level accountability systems. One of our accountability metrics updates the old Gainful Employment debt-to-earnings tests, which we call Gainful Employment Equivalent.

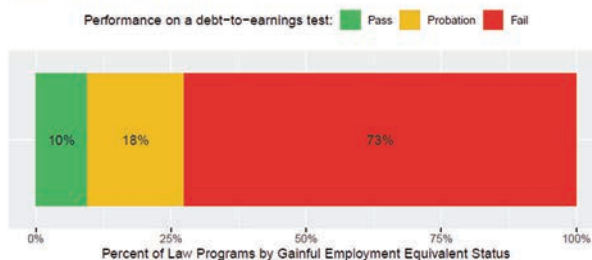
For example, we analyzed the performance of the largest academic fields by conducting the Gainful Employment Equivalent tests on all programs with earnings and student loan debt. We then grouped programs by academic field and aggregated each field’s performance, weighting each program by the number of graduates who received federal financial aid and worked one year after graduation (referred to simply as graduates hereafter for simplicity). The figure below shows wide variation in debt-to-earnings outcomes by academic field. In many fields, such as mechanical engineering, nursing, and vehicle maintenance and repair, 90% or more of recent graduates received their degree from a program passing Gainful Employment Equivalent. However, some fields had much worse outcomes. In the fields of social work and biology, for instance, only around a third of recent graduates completed at a program passing Gainful Employment Equivalent.

Which Academic Fields Prepare College Graduates for Success?



Law stood out as the academic field with the worst outcomes, so we performed an in depth analysis of professional degree programs in law. We found that only 10% of law schools pass Gainful Employment Equivalent as seen in the figure below (reproduced from *Objection! Law schools can be hazardous to students' financial health*).⁴

How Well Do Law Programs Perform?



Note: Data from U.S. Department of Education and author's calculations.

We have also looked at performance by university rather than by academic field. For example, to help inform Texas policymakers, we analyzed the student loan debt and earnings for all public universities in Texas, and found 58 programs that left their students with excessive debt.⁵

We are currently analyzing the most recent data from ED, and will soon be releasing research that updates and expands on these analyses.

Thank you again for the opportunity to provide this testimony and I look forward to answering any questions you may have.

⁴ Andrew Gillen, *Objection! Law schools can be hazardous to students' financial health*, Texas Public Policy Foundation, 2020.

⁵ Thomas K. Lindsay and Andrew Gillen, *Which Texas Public College Degrees Require Excessive Student Debt?*, Texas Public Policy Foundation, 2020.

Chairman SCOTT. Thank you. Ms. Emrey-Arras.

**STATEMENT OF MELISSA EMREY-ARRAS, DIRECTOR,
EDUCATION, WORKFORCE AND INCOME SECURITY ISSUES,
U.S. GOVERNMENT ACCOUNTABILITY OFFICE**

Ms. EMREY-ARRAS. Good morning, Chairman Scott, Republican Leader Foxx, and Members of the committee. I am pleased to be here today to discuss GAO's report on for-profit college conversions. I will focus my remarks on three issues. One, what is known about insider involvement in college conversions.

Two, IRS's oversight of college conversions. And three,

the Department of Education's oversight of college conversions. Beginning with a look at insider involvement, we found that about a third of the 59 for-profit college conversions we identified involved insiders.

Collectively, colleges with insider conversions received nearly 1.8 billion in Federal student aid funds in the 2018–19 award year. Insiders may be the for-profit colleges former owners, or their family Members, executives, or board Members who continue to play a leadership role in the new non-profit college.

While leadership continuity can benefit a college, insider involvement poses a risk that insiders may improperly benefit financially. For example, insiders could influence the non-profit to pay more for the for-profit college than it is worth, or insiders could steer college contracts toward businesses the insiders' control through an inflated price.

Doing so would be prohibited under the Internal Revenue Code and the Higher Education Act, which do not allow a non-profit's earnings to improperly benefit private individuals. In addition, in examining the financial health of colleges converting, we found that colleges with insider conversions generally had stronger financial performance before their conversions.

For example, all of the colleges with insider conversions had a passing education financial responsibility score the year before their sale, however, almost all of them had a failing financial score the year of their sale.

Turning now to how the IRS oversees college conversions we found that IRS guidance directs staff to closely scrutinize whether insider transactions exceed fair market value and improperly benefit insiders. If an application contains insufficient information to make that assessment, guidance says the staff may need to request additional information.

However, we found that for two of the planned or final conversions involving insiders, IRS approved the application without certain information. For example, IRS approved college conversions without information on the college's planned purchase price, or the appraisal report estimating the college's value.

Without such information IRS staff could not assess whether the price was inflated to improperly benefit insiders which would be grounds to deny the application. Accordingly, we recommended the IRS assess and improve its application review process.

Now turning to education. We found that education had strengthened its reviews of for-profit college conversion applications. As of August 2020, education had approved 35 of the 59 colleges for non-profit status and denied two. The remaining applications were under review or no longer required action because the colleges had closed.

However, in terms of monitoring colleges after approving them as non-profits, we found that education does not monitor the newly converted colleges to assess ongoing risk of improper benefit. In two of the three cases we reviewed in-depth, we found college financial statements disclosed transactions with insiders that could indicate the risk of improper benefit.

Consequently, we recommended that education develop procedures to review financial statements to monitor newly converted colleges. In conclusion, for-profit college conversions involving insiders can pose risks to students and taxpayers.

If a non-profit college's revenues are diverted to improperly benefit insiders, funds available to support the college's educational mission can be reduced, potentially harming the college and its students, and violating Federal requirements.

We believe that GAO's recommendations will help IRS and education address these risks. This completes my statement, and I will be pleased to answer any questions you may have.

[The prepared statement of Ms. Melissa Emrey-Arras follows:]

PREPARED STATEMENT OF MELISSA EMREY-ARRAS



United States Government Accountability Office

Testimony
Before the Committee on Education and
Labor, House of Representatives

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HIGHER EDUCATION

IRS and Education Could Better Address Risks Associated with For-Profit College Conversions

Statement of Melissa Emrey-Arras, Director
Education, Workforce, and Income Security



Chairman Scott, Republican Leader Foxx, and Members of the Committee:

I am pleased to be here today to discuss for-profit college conversions. To become a tax-exempt nonprofit college, a for-profit college must be recognized as tax-exempt by the Internal Revenue Service (IRS) and be approved as a nonprofit college by the Department of Education (Education). A for-profit college may seek to become a tax-exempt nonprofit college for a variety of reasons. For example, it may wish to better align its status with its mission or obtain access to certain federal or state grants. A for-profit college may also wish to obtain perceived reputational benefits of nonprofit college status. In some cases, a for-profit college may seek to reduce its tax burden or avoid federal student aid limits applicable to for-profit colleges.¹

In some conversions, the former owner and other executives associated with the previously for-profit college have no role in the new nonprofit college. For example, the owner of a for-profit college who wants to retire may sell the college to an existing nonprofit college and have no continuing association with the college. In other conversions, the for-profit college's former owners or their family members, executives, or board members may continue to play a leadership role in the newly nonprofit college. IRS guidance refers to such individuals with influence over a nonprofit organization, like a college, as insiders.² The ongoing involvement of insiders familiar with a college's history and operations can promote continuity and stability. However, there is also a risk that insiders may use their influence to improperly benefit themselves financially at the expense of the college's nonprofit mission—for instance, by steering college contracts toward businesses the insiders control for an inflated price. Doing so would be impermissible under the Internal

¹We define federal student aid programs as financial aid programs authorized under Title IV of the Higher Education Act of 1965, as amended (Higher Education Act). These include the William D. Ford Federal Direct Loan, the Federal Pell Grant, and the Federal Work-Study programs.

²According to IRS officials, the term "insider" is derived from the definition of "private shareholders and individuals" in statute and regulations and as interpreted by judicial decisions. Treasury Regulations define the term "private shareholder or individual" in section 501 of the Internal Revenue Code to refer to "persons having a personal and private interest in the activities of the organization." See 26 C.F.R. § 1.501(a)-1(c). Courts have interpreted this term to mean an insider of the charity. See *United Cancer Council, Inc. v. Comm'r*, 165 F.3d 1173, 1176 (7th Cir. 1999). If the net earnings of an organization inure in whole or in part to the benefit of insiders, the organization is not operated exclusively for one or more tax-exempt purposes.

Revenue Code and the Higher Education Act, which require that a nonprofit college operate exclusively for tax-exempt purposes and prohibit any of its earnings from being used to improperly benefit private individuals.³

My testimony today is based on our December 2020 report on for-profit college conversions.⁴ My statement addresses (1) what is known about insider involvement in for-profit college conversions, (2) the extent to which IRS identifies and responds to the risk of improper benefit associated with for-profit colleges that apply for and obtain tax-exempt status, and (3) the extent to which Education identifies and responds to the risk of improper benefit associated with for-profit colleges that apply for, and those that successfully obtain, nonprofit status in federal student aid programs.⁵ I will also highlight three actions we recommended to improve agency oversight of conversions—two to IRS and one to Education. Our December 2020 report relied on multiple methodologies which are described in more detail in that report, along with our assessment of data reliability. For this testimony, we also requested updates from IRS and Education officials on the progress of the agencies in implementing our recommendations from the 2020 report, along with an update of Education's ongoing actions to provide advertising instructions to colleges.

The work upon which this statement is based was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

³See 20 U.S.C. § 1003(13) and 26 U.S.C. § 501(c)(3).

⁴See GAO, *Higher Education: IRS and Education Could Better Address Risks Associated with Some For-Profit College Conversions*, GAO-21-89 (Washington, D.C.: Dec. 31, 2020).

⁵We use the term for-profit college conversion to refer to a college's transition from for-profit ownership to ownership by a nonprofit organization recognized by the IRS as tax-exempt. The college must separately apply to Education for nonprofit college status. See 20 U.S.C. §§ 1003(13) and 1094(a).

Background

To obtain nonprofit college status, a for-profit college must first be recognized as tax-exempt by IRS and then obtain Education approval to participate in federal student aid programs as a nonprofit college.⁶

IRS Tax-Exempt Status and Monitoring

A for-profit college may obtain IRS tax-exempt status in a variety of ways. For example, a for-profit college may apply to IRS directly for tax-exempt status after reincorporating as a nonprofit organization at the state level. In other cases, a for-profit college may obtain tax-exempt status after its sale to a new nonprofit organization created to purchase the college or an existing nonprofit organization that has already been approved by IRS as tax-exempt. Owners or executives of the for-profit college may already have a relationship with the nonprofit organization and be involved in initiating the conversion (see figure 1).

Figure 1: Examples of How Insiders Can Initiate a For-Profit College Conversion



Source: GAO analysis of Internal Revenue Service (IRS) documents. | GAO-21-500T

Notes: IRS defines insiders as private shareholders or individuals with a personal and private interest in a tax-exempt organization's activities who, through a special relationship with the organization, are able to influence its financial decisions. Insiders associated with a for-profit college conversion would include for-profit college owners, their family members, board members, or executives who hold leadership roles in a nonprofit organization that purchases the college.

Nonprofit organizations recognized by IRS as tax-exempt and nonprofit colleges recognized as such by the Department of Education (Education) are prohibited from using their earnings to improperly

⁶We use the term nonprofit college to refer to an institution of higher education that has been approved by Education to participate in federal student aid programs as a nonprofit college.

benefit private individuals. See 20 U.S.C. § 1003(13), 26 U.S.C. § 501(c)(3), and 26 C.F.R. § 1.501(c)(3)-1(c)(2).

*Education has additional processes for approving a for-profit college to become a nonprofit college for federal student aid purposes.

When applying to IRS for tax-exempt status, a nonprofit organization provides information that IRS uses to assess whether the organization is organized and operated exclusively for tax-exempt purposes and to ensure that no part of the applicant's net earnings improperly benefit insiders, such as the organization's founders.⁷ Improper benefit is impermissible and is grounds for denial or revocation of tax-exempt status under the Internal Revenue Code (see text box).⁸

Improper Benefit

Inurement, which GAO refers to in this statement as improper benefit, occurs when the earnings of a tax-exempt organization are used to benefit persons with a personal and private interest in the activities of an organization. Such persons are typically insiders in a position to influence the organization's financial decisions. Improper benefit is impermissible for tax-exempt organizations, including colleges, under the Internal Revenue Code and for nonprofit colleges, under the Higher Education Act of 1965, as amended.

Source: 20 U.S.C. § 1003(13), 26 U.S.C. § 501(c)(3), and 26 C.F.R. § 1.501(c)(3)-1(c)(2); GAO-21-500T

IRS generally relies on information provided by the applicant to determine if the requirements of tax-exempt status are met. However, IRS staff members may ask questions or request documentation to help them assess whether the organization meets the requirements of tax-exempt status.

After IRS has approved an organization for tax-exempt status, the organization is generally required to submit annual filings with information on their activities and finances.⁹ IRS selects tax-exempt organizations for

⁷Colleges seek exemption from federal taxation as educational organizations under section 501(c)(3) of the Internal Revenue Code. See 26 U.S.C. § 508. These organizations are generally required to submit an application for tax-exempt status.

⁸Tax-exempt organizations are not prohibited from entering into financial transactions with insiders. For instance, nonprofit board members or executives may sell property to nonprofit organizations or operate businesses that provide services to them. However, it is prohibited for such transactions to benefit those individuals' private financial interests over the financial interests of the nonprofit organization. See 26 C.F.R. § 1.501(c)(3)-1(c)(2). Insiders may include a tax-exempt organization's founders, members of its board, their families, and others. The test is functional and looks to the reality of control rather than to the insider's place in a formal table of organization. See 26 C.F.R. § 1.501(a)-1(c) and United Cancer Council, Inc. v. Comm'r, 165 F.3d 1173, 1176 (7th Cir. 1999).

⁹If an existing tax-exempt organization purchases a for-profit college, it would describe its new activities, such as operating a college, on its next annual IRS filing.

audit based on indicators of potential noncompliance contained in these annual filings.¹⁰ In some cases, IRS initiates audits as a part of special projects called compliance strategies, which focus on specific areas of tax noncompliance, such as improper benefit to insiders. If IRS finds tax noncompliance through an audit, it can impose penalties on an organization, and may revoke tax-exempt status if it finds that the organization improperly benefits insiders.

**Education Nonprofit
College Status and
Monitoring**

After a for-profit college has obtained tax-exempt status, it must separately obtain approval from Education to participate in federal student aid programs as a nonprofit college.¹¹ To be recognized by Education as a nonprofit college, a college must be:

1. authorized to operate as a nonprofit by each state in which it is physically located;
2. recognized by IRS as a tax-exempt organization; and
3. owned and operated by a nonprofit organization whose earnings do not improperly benefit insiders.¹²

Education evaluates an application for nonprofit college status submitted by a for-profit college, or a group of colleges with the same owner, that has undergone a conversion transaction. These applications contain information including (1) proof of accreditor, state, and IRS approval; (2) two years of audited financial statements; and (3) a copy of the college or college group's balance sheet as of the day it changed owners. Once Education approves a for-profit college's application for nonprofit college status, the college is required to participate in federal student aid programs under provisional approval for at least 1 to 3 years. Colleges that are provisionally approved are subject to additional requirements—

¹⁰Technically, IRS selects an annual filing submitted by tax-exempt organizations for examination. In this statement, we refer to this IRS process as an audit.

¹¹Until Education approves a tax-exempt college's application for nonprofit college status, Education treats the college as a for-profit college for federal student aid purposes. Colleges are also required to report all changes in ownership for Education's approval. Education can approve a for-profit college's change in ownership to a tax-exempt owner, while denying the college's request to be treated as a nonprofit college.

¹²See 20 U.S.C. §§ 1003(13) and 1094(a). The Higher Education Act also requires colleges to be accredited by an entity (i.e., an accreditor) recognized by Education as a reliable authority on assessing academic quality. See 20 U.S.C. § 1001(a)(5). College accreditors must have adequate policies for approving substantive changes—such as a conversion from for-profit to nonprofit status—undertaken by member colleges. See 34 C.F.R. § 602.22(a).

for instance, they may be temporarily prohibited from adding new programs or opening new locations—and are monitored by Education to ensure they comply with the specified provisional conditions.

Education also has ongoing monitoring activities applicable to all colleges, such as periodic recertification of all colleges' eligibility to participate in federal student aid programs and more in-depth program reviews to assure that selected colleges are complying with key federal student aid requirements. In addition, Education annually reviews the audited financial statements of all colleges as part of its process to assess their financial health. Education can impose sanctions and corrective actions on colleges that violate program rules.

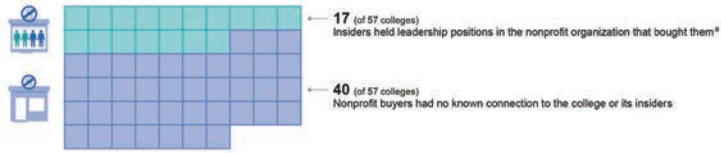
Some For-Profit College Conversions Involved Insiders, Which May Pose Risk of Improper Benefit

In our December 2020 report, we identified 59 for-profit colleges that underwent conversion transactions from January 2011 through August 2020. We reviewed public IRS filings and found that in nearly one-third of cases with available information (17 of 57), for-profit college officials were insiders to the college's tax-exempt purchaser, holding nonprofit leadership roles before or upon conclusion of the conversion transaction.¹³ By contrast, the other two-thirds of colleges in our review (40 of 57) were sold to unrelated nonprofit organizations (see figure 2). Collectively, colleges whose conversions involved insiders received nearly \$1.8 billion in federal student aid funds in the 2018-2019 award year.¹⁴

¹³We excluded two of 59 colleges from this analysis. In one case, we did not have sufficient information to assess the relationship between one for-profit college and the nonprofit organization that purchased it. In the other case, the college had previously been recognized by Education as nonprofit, but lost its IRS tax-exempt status after IRS found it had violated racial nondiscrimination rules applicable to tax-exempt schools and colleges. As a result, it no longer met Education's definition of a nonprofit college. The college was later donated to a tax-exempt school associated with the college and regained its tax-exempt status from IRS.

¹⁴Of the 17 colleges whose conversions involved insiders in our review, one closed prior to the 2018-2019 award year and three merged with another related college in our review. These colleges did not separately receive any federal student aid funds in the 2018-2019 award year as a result.

Figure 2: For-Profit College Conversions with and without Insider Involvement, January 2011 through August 2020



Source: GAO analysis of Internal Revenue Service (IRS) documents. | GAO-21-500T

Note: GAO used the term "nonprofit organization" to refer to an organization recognized by IRS as tax-exempt and "conversion" to refer to a college's transition from for-profit ownership to ownership by a nonprofit organization recognized by IRS as tax-exempt. This review included all for-profit colleges that had (1) undergone a conversion transaction between January 2011 and August 2020 and (2) submitted an application to Education to be recognized as a nonprofit college or to merge with an existing nonprofit college as of August 2020, regardless of whether Education made a decision to approve or deny the application. The 57 colleges in this analysis were acquired by 18 separate tax-exempt organizations. In most cases (13 of 18), one college was acquired. However, in five cases, the tax-exempt organization purchased more than one college—up to 20 colleges in one case. Insiders are defined as persons with a personal and private interest in a tax-exempt organization's activities who, by virtue of a special relationship with the organization, are able to influence its financial decisions. GAO considered for-profit college officials to be insiders to the college's nonprofit purchaser if (1) for-profit college owners, their family members, board members, or executives held leadership roles in the nonprofit organization that purchased the college or (2) for-profit college owners with a more than 35-percent stake in the college assumed nonprofit leadership roles after the purchase was complete. Tax-exempt organizations are not prohibited from entering into financial transactions with insiders. However, it is prohibited for such transactions to improperly benefit those individuals' private financial interests over the financial interests of the nonprofit organization.

*In one case, the for-profit college reincorporated as a nonprofit organization rather than being sold to an outside nonprofit organization. The for-profit college's owners continued to lead the college after its reincorporation.

Insider involvement in a conversion may have benefits for a college, such as enhancing operational stability; however, it also poses a risk that the college's earnings could be used to improperly benefit insiders rather than the college's nonprofit mission. For instance, if a nonprofit organization's board does not exercise due diligence when it purchases a for-profit college from insiders, those insiders could influence the board to purchase the college for more than it is worth. As a result, the insiders would improperly benefit from the inflated price (see figure 3). Similarly, former for-profit college owners who continue to lead a newly tax-exempt college after selling it could influence that college to rent facilities from companies they own for an over-market rates resulting in improper benefit to the former owners.

Figure 3: Hypothetical Example of How Insiders Could Improperly Benefit from a For-Profit College Conversion



Source: GAO analysis of Internal Revenue Service (IRS) documents. | GAO-21-500T

Note: Inurement, referred to in this report as improper benefit, is impermissible under the Internal Revenue Code and the Higher Education Act of 1965, as amended, for tax-exempt organizations and nonprofit colleges, respectively. It occurs when a tax-exempt organization's or nonprofit college's earnings benefit the private interests of insiders, who by virtue of a special relationship with the organization have the ability to influence its financial decisions, rather than the interests of the organization. Tax-exempt organizations are not prohibited from entering into financial transactions with insiders. However, it is prohibited for such transactions to improperly benefit the financial interests of insiders over those of the nonprofit organization.

Roles of insiders in five case study colleges: In our December 2020 report, we described five case study colleges whose conversions involved insiders for more in-depth review.¹⁵ In four of five cases, insiders led the college's nonprofit purchaser (e.g., as founder or board chair) before the conversion transaction. In all five cases, former owners or shareholders continued to serve as the college's president or chief executive officer after the sale.¹⁶ In addition, because each conversion transaction was seller-financed, all five newly tax-exempt colleges made loan payments to the for-profit seller while an individual with an ownership stake in the for-profit seller continued to lead the college. In two of five cases, former owners also acted as landlord to colleges, leasing back properties that were not included in the original sale. Further, in three of five cases, former owners acted as vendors to the tax-exempt college. One college president owned companies that provided a wide variety of services to the tax-exempt college. In another case, the college president was also

¹⁵The five colleges selected for case studies are not representative of all for-profit college conversions with insider involvement, but rather serve as illustrative examples. Because our review focused on IRS and Education oversight, we did not conduct an audit of any college to determine whether its conversion improperly benefitted insiders.

¹⁶Insiders also assumed roles on the board of the newly tax-exempt college in three of five cases.

the chief executive of the college's former corporate owner and an extensive service provider.

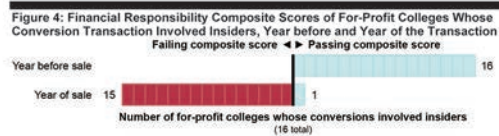
As discussed in our December 2020 report, officials from our five case study colleges described positive goals for their conversion, such as enhancing the student experience (four of five cases), aligning the college's status with its character or mission (three of five cases), and bolstering college resources by enabling it to accept charitable contributions (two of five cases). They also described benefits from the ongoing leadership of officials familiar with the college.

Officials from all five case study colleges also reported safeguards that could mitigate the risk of improper benefit. In particular, officials from all five colleges said they used professional opinions from independent experts (e.g., financial valuation firms or appraisers) when negotiating their conversion transaction and utilized conflict of interest policies. Officials from four of five colleges also described taking steps over time to end or reduce certain financial ties with former owners. For instance, officials from two of five colleges noted that they later refinanced the loans they owed to former owners with unrelated parties.

Financial performance based on Education measures: Using Education financial measures, we reported that colleges converting with insiders involved generally had stronger performance before their conversion, but weaker performance in the year of their sale, whereas the opposite was true for most colleges converting without insiders involved. All 16 of the for-profit colleges whose conversions involved insiders and had available information also had a passing financial responsibility composite score—which Education calculates annually to assess a college's financial health—in the year before its sale.¹⁷ However, almost

¹⁷The final college whose conversion involved insiders did not yet have a composite score available for the year of its conversion transaction at the time of our review. Education calculates the financial responsibility composite score using audited financial statement data for all for-profit and nonprofit colleges annually. It is composed of three financial ratios: (1) the primary reserve ratio, which measures whether the college has sufficient resources to cover its expenses; (2) the equity ratio, which measures how much the college owns versus how much it owes; and (3) the net income ratio, which measures whether the college operates within its means. Education uses slightly different formulas when calculating these ratios for nonprofit and for-profit schools. See 34 C.F.R. § 668.172 and apps. A-B.

all of these colleges whose conversions involved insiders (15 of 16) had a failing composite score in the year of its sale (see figure 4).¹⁸



Source: GAO analysis of Department of Education (Education) data. | GAO-21-500T

Notes: GAO used the term "nonprofit organization" to refer to an organization recognized by IRS as tax-exempt and "conversion" to refer to a college's transition from for-profit ownership to ownership by a nonprofit organization recognized by IRS as tax-exempt. This review included all for-profit colleges that had (1) undergone a conversion transaction between January 2011 and August 2020 and (2) submitted an application to Education to be recognized as a nonprofit college or to merge with an existing nonprofit college as of August 2020, regardless of whether Education made a decision to approve or deny the application.

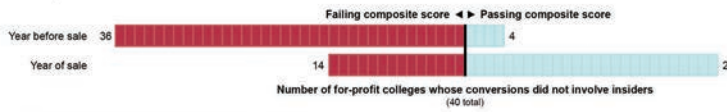
Insiders are defined as persons with a personal and private interest in a tax-exempt organization's activities who, by virtue of a special relationship with the organization, are able to influence its financial decisions. GAO considered for-profit college officials to be insiders in a conversion if (1) for-profit college owners, their family members, board members, or executives held leadership roles in the nonprofit organization that purchased the college or (2) for-profit college owners with a more than 35-percent stake in the college assumed nonprofit leadership roles after the purchase was complete. Tax-exempt organizations are not prohibited from entering into financial transactions with insiders. However, it is prohibited for such transactions to improperly benefit those individuals' private financial interests over the financial interests of the nonprofit organization.

Education conducts annual financial responsibility reviews for all for-profit and nonprofit colleges that participate in federal student aid programs and calculates a financial responsibility composite score as a part of this review. Education conducts one financial review for each group of colleges with the same owner; as a result, those colleges in GAO's review that shared the same for-profit owner prior to their conversion and the same nonprofit owner after their conversion generally would also share the same financial responsibility composite score. This score is composed of three financial ratios that measure whether the college has sufficient resources to cover its expenses (primary reserve ratio), how much the college owns versus how much it owes (equity ratio), and whether the college operates within its means (net income ratio). Education requires colleges with failing scores to provide a letter of credit and agree to heightened cash monitoring and other oversight requirements. Education uses slightly different formulas when calculating these ratios for nonprofit and for-profit schools. See 34 C.F.R. § 668.172 and apps A-B.

¹⁸Education requires colleges with failing composite scores to provide letters of credit of at least 10 percent of their federal student aid funds from its most recent fiscal year as an assurance to Education against potential losses. Colleges obtain the letter of credit from a bank, which charges them a fee for this service—typically a percentage of the value of the letter of credit. The letter of credit protects Education against potential liabilities for student refunds, loan cancellation costs, and other costs associated with a college closure. In such cases, Education can cash the letter of credit to cover any outstanding debts owed by the college. In addition to providing a letter of credit, colleges with failing composite scores must also agree to heightened cash monitoring and other oversight requirements.

By contrast, the large majority of for-profit colleges that converted without insider involvement were in financial distress before their sale. Specifically, 36 of 40 had failing financial responsibility composite scores and 33 were nearing bankruptcy.¹⁹ After their sales, most of these colleges (26 of 40) had passing financial responsibility composite scores (see figure 5).²⁰

Figure 5: Financial Responsibility Composite Scores of For-Profit Colleges Whose Conversion Transaction Did Not Involve Insiders, Year before and Year of the Transaction



Source: GAO analysis of Department of Education (Education) data. | GAO-21-500T

Notes: GAO used the term "nonprofit organization" to refer to an organization recognized by IRS as tax-exempt and "conversion" to refer to a college's transition from for-profit ownership to ownership by a nonprofit organization recognized by IRS as tax-exempt. This review included all for-profit colleges that had (1) undergone a conversion transaction between January 2011 and August 2020 and (2) submitted an application to Education to be recognized as a nonprofit college or to merge with an existing nonprofit college as of August 2020, regardless of whether Education made a decision to approve or deny the application.

Insiders are defined as persons with a personal and private interest in a tax-exempt organization's activities who, by virtue of a special relationship with the organization, are able to influence its financial decisions. GAO considered for-profit college officials not to be insiders in a conversion if: (1) for-profit college owners, their family members, board members, or executives did not hold leadership roles in the nonprofit organization that purchased the college or (2) for-profit college owners with a more than 35 percent stake in the college did not assume nonprofit leadership roles after the purchase was complete. Tax-exempt organizations are not prohibited from entering into financial transactions with insiders. However, it is prohibited for such transactions to improperly benefit those individuals' private financial interests over the financial interests of the nonprofit organization.

Education conducts annual financial responsibility reviews for all for-profit and nonprofit colleges that participate in federal student aid programs and calculates a financial responsibility composite score as a part of this review. Education conducts one financial review for each group of colleges with the same owner; as a result, those colleges in GAO's review that shared the same for-profit owner prior to their conversion and the same nonprofit owner after their conversion generally also share the same financial responsibility composite scores. This score is composed of three financial ratios that measure whether the college has sufficient resources to cover its expenses (primary reserve ratio), how much the college owns versus how much it owes (equity ratio), and whether the college operates within its means (net income ratio). Education requires colleges with failing scores to provide a letter of credit and agree to heightened cash monitoring and other oversight requirements. Education uses

¹⁹The 33 colleges nearing bankruptcy were part of two separate conversion transactions involving groups of for-profit colleges sold to two different nonprofit purchasers.

²⁰The other 14 colleges had failing composite scores before and after their sale. All but one of these colleges were purchased by the same nonprofit organization from a large for-profit college chain nearing bankruptcy.

slightly different formulas when calculating these ratios for nonprofit and for-profit schools. See 34 C.F.R. § 668.172 and apps. A-B.

According to Education officials, a college's financial condition may decline or improve following its sale depending on factors such as the relative size and financial resources of the college and its purchaser. One Education official stated that if a college's nonprofit purchaser assumes a high level of debt to purchase the college or has limited access to working capital, it could harm the college's financial health. Conversely, another Education official stated that if a college's purchaser is more financially stable than the college it is purchasing, it may strengthen the purchased college's financial health.

While assessing the current financial condition of all converted colleges was not within the scope of our review, in December 2020 we noted that a college's financial condition may also change over time. A college whose financial condition improves after its sale may find that improvement short-lived, for instance, if its new owners lack the expertise needed to successfully operate a college. Conversely, a college whose financial condition declines after its sale may ultimately experience improved financial circumstances if its ability to attract and retain students improves and the college pays down debt associated with its change in ownership.²¹

IRS Did Not Consistently Identify and Respond to Risks That Insiders May Improperly Benefit from Previously For-Profit Colleges

²¹ Four of our five case study colleges had failing composite scores in the year of their conversion transaction; in two cases, the colleges' composite scores improved to passing in the most recent year available. These colleges both repaid some debt associated with their change in ownership. In addition, former owners forgave a substantial proportion of both colleges' outstanding debt in the years following the sale, which had a positive effect on both colleges' composite scores.

IRS Staff Did Not Always Seek Information to Assess the Risk of Improper Benefit to Insiders When Reviewing Applications for Tax-Exempt Status

In our December 2020 report, we found that IRS staff reviewing for-profit college applications for tax-exempt status did not always seek information to assess whether insiders would improperly benefit from conversions. Improper benefit is grounds to deny an application for tax-exempt status and IRS staff training materials instruct staff to carefully scrutinize applications that disclose a for-profit conversion transaction to determine whether it will be consistent with fair market value or improperly benefit insiders.²² However, we found that in two cases IRS approved applications for tax-exempt status that disclosed plans to purchase a for-profit college from insiders without IRS knowing the college's planned sale price.²³ Further, IRS staff did not request other information—such as an independent appraisal report estimating the college's value—that could help IRS staff assess whether the applicant would meet tax-exempt requirements.

In both cases, the organizations applying for tax-exempt status were created by insiders expressly to purchase a for-profit college. However, instead of disclosing the college's planned sale price or copies of independent appraisal reports, both applications stated that independent appraisals would be conducted in the future and that the sale prices, once determined, would not exceed fair market value. Both applications also disclosed plans to purchase extensive contractual services from the colleges' former for-profit owners. However, only one application disclosed how much the college planned to pay for services, and neither provided an independent appraisal report estimating the value of the services.²⁴

²²According to Department of the Treasury regulations, fair market value is the price at which an asset (such as a college) would change hands between a willing buyer and willing seller, when both have reasonable knowledge of the relevant facts and neither is obligated to buy or sell. IRS guidelines state an applicant for tax-exempt status can demonstrate that a purchase from insiders does not exceed fair market value, for example, by disclosing the purchase price or providing an independent appraisal report to support it, among other types of evidence. According to regulations, paying more than fair market value for assets sold by insiders would result in improper benefit and be grounds for IRS to deny the applicant's application for tax-exempt status.

²³Altogether, 11 planned conversions involving insiders were disclosed in an application for tax-exempt status, including 10 of the 17 for-profit college conversions involving insiders in our review and an additional planned for-profit college conversion that ultimately did not occur.

²⁴IRS training materials state that staff should carefully assess whether the contracts exceed the fair market value of the services being provided.

According to IRS officials, assurances from the applicants that independent appraisals would be conducted and that the eventual transaction prices would not exceed fair market value provided a sufficient basis for the agency's decision to approve these applications.²⁵ However, each applicant had a for-profit history, which an IRS staff information sheet says poses a heightened risk of improper benefit. Further, each application disclosed significant planned transactions with insiders, which IRS staff instructions direct staff to assess carefully.

The complexity of for-profit college conversions that involve insiders and the potential risk they pose heighten the importance of robust quality assurance practices. Standards for internal control in the federal government state that management should mitigate risks by periodically reviewing the effectiveness of internal control policies and procedures.²⁶ At the time of our study, however, IRS officials stated that they had not assessed whether the agency's internal controls were sufficient to provide reasonable assurance that staff consistently follow guidance to evaluate the risk of improper benefit associated with for-profit college applications for tax-exempt status. In response, we recommended that the Commissioner of Internal Revenue assess these internal controls and improve the review process to ensure that staff appropriately apply agency guidance on assessing potential improper benefit to insiders. As of March 2021, IRS officials said that they were in the process of assessing the agency's internal controls for reviewing for-profit college applications for tax-exempt status and would make any improvements to its controls and processes as appropriate based on the review.

IRS Did Not Collect Sufficient Information to Identify Previously For-Profit Colleges with Tax-Exempt Status for Oversight Purposes

Although IRS conducts audits of tax-exempt organizations at risk of noncompliance with federal tax law, we found in our December 202 report that it did not collect the information it needs to systematically identify colleges or other organizations with a for-profit history for potential audit. In our December 2020 report, seven of the 17 for-profit college conversions in our review that involved insiders were not disclosed in an application for tax-exempt status because the college's purchaser was already tax-exempt. As a result, IRS did not have the opportunity to review these conversions as a part of its decision to grant the purchaser

²⁵Officials further noted that decisions to grant or deny tax-exempt status are based on representations provided by applicants, and that staff do not audit applicants before making their determination.

²⁶GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.: September 2014).

tax-exempt status. Instead, an audit would be IRS's first opportunity to assess whether these conversions involving an existing tax-exempt organization were consistent with the requirements of tax-exempt status.

However, as we described in our December 2020 report, the annual filing IRS uses to select tax-exempt organizations for audit does not have a data field that asks whether the organization has purchased a for-profit entity or otherwise has a for-profit history. The lack of information in an easily searchable data field means that IRS cannot systematically select for audit tax-exempt organizations whose annual filings disclose purchasing a for-profit college from insiders. This lack of information hampered IRS's oversight efforts when IRS implemented a compliance strategy whose goal was to identify tax-exempt colleges and other organizations that have been part of a for-profit conversion, due to their heightened risk of improper benefit.²⁷ Because IRS had minimal data on tax-exempt organizations with a for-profit history, it used complex data matching techniques to try to identify them. However, these techniques did not identify any of the existing tax-exempt organizations that purchased the seven for-profit colleges from insiders in our review.

IRS could require tax-exempt organizations to report the purchase of a for-profit college or other for-profit entity in a searchable data field on their annual IRS filing, but it has not done so. IRS officials stated that doing so was unnecessary since the agency's application form for tax-exempt status asks applicants whether they have a for-profit history. However, an existing tax-exempt organization does not need to submit a new application form when it purchases a for-profit college. Standards for internal control in the federal government state that agencies should use quality information to make decisions.²⁸ We therefore recommended that the Commissioner of Internal Revenue collect information that would enable the agency to systematically identify tax-exempt colleges with a for-profit history for audit and other compliance activities. As of March 2021, IRS officials reported that they planned to evaluate the benefits and burdens of collecting additional information about the for-profit history of tax-exempt organizations, including colleges. We continue to believe that collecting such information would better position IRS to systematically

²⁷The agency began developing this strategy due to concerns about for-profit college conversions, but broadened it to include all for-profit entity conversions that involved tax-exempt organizations, without regard to the organization's tax-exempt purpose.

²⁸GAO-14-704G

identify organizations with a for-profit history, which the agency acknowledges pose a heightened risk of improper benefit.

While Education Began Reviewing Nonprofit Applications More Closely, It Did Not Take Steps to Assess the Risk of Improper Benefit among Newly Converted Colleges

Education Enhanced Its Reviews of For-Profit College Applications for Nonprofit Status and Developed Advertising Instructions

As we reported in December 2020, Education had enhanced its process for reviewing applications from for-profit colleges seeking to convert to nonprofit college status in recent years. From November 2010 through August 2020, 59 for-profit colleges, which were part of 20 separate conversion transactions, applied to Education for nonprofit college status.²⁹ As of August 2020, Education had approved 35 of these 59 colleges for nonprofit status and denied two. The remaining applications were under review or no longer required action because the colleges had closed (see figure 6).

²⁹These 59 colleges were acquired by 20 separate tax-exempt organizations. A few tax-exempt organizations acquired more than one college—up to 20 colleges in one case. In one case, the for-profit college itself reincorporated as a nonprofit organization (rather than being purchased by a separate nonprofit organization).

Figure 6: Application Status of For-Profit Colleges That Completed Conversion Transactions between January 2011 and August 2020 and Applied to Education for Nonprofit College Status as of August 2020



Source: GAO analysis of Department of Education documents. | GAO-21-500T

Notes: We use the term for-profit college conversion to refer to a college's transition from for-profit ownership to ownership by a nonprofit organization recognized by IRS as tax-exempt. The college must separately apply to Education for nonprofit college status. See 20 U.S.C. §§ 1003(13) and 1094(a).

The 59 colleges in GAO's review were part of 20 separate conversion transactions. Most of these transactions (15 of 20) involved just one college. However, five of the 20 conversion transactions involved the sale of multiple for-profit colleges to a single tax-exempt organization. In such cases, Education may conduct one conversion review for the entire group. In addition, two of the 59 colleges were purchased by an existing nonprofit college and applied to merge with the nonprofit college, rather than applying to be recognized as nonprofit colleges themselves.

[†]In 2016, Education denied an application for nonprofit status from four related colleges, but later approved the colleges for nonprofit status following the resolution of key agency concerns. These four colleges are included in GAO's count of 35 colleges approved for nonprofit status by Education and excluded from GAO's count of colleges denied for nonprofit status.

*These colleges continue to participate in federal student aid programs as for-profit colleges.

In our review, Education officials explained that prior to 2016 the agency did not have well-developed guidance or a specialized work group to evaluate complex changes in ownership, such as nonprofit conversions. In our review of three case study colleges that Education approved for nonprofit college status, we found that agency staff did not identify or follow up on potential risks of improper benefit in either of the case study colleges whose conversions Education approved prior to 2016.³⁰ However, Education began developing a more robust review process in 2016 and the agency started requesting copies of documents—such as names of board members, purchase and sale agreements, and appraisal

³⁰Because we did not conduct an audit of any college in our review to determine whether insiders improperly benefitted from any conversion, we did not assess whether Education reached the appropriate decision with respect to any college's application for nonprofit status in our review.

reports—to assess risk of improper benefit to insiders, according to agency officials. Education reviewed the application for one of our case study colleges after 2016 and obtained additional information, such as lease and debt terms, which agency officials said they used to assess whether the former owners were benefitting improperly from those agreements.

Education took additional steps to improve its processes in September 2018 when it created a centralized team composed of Education staff with contract review, finance, and legal expertise to help staff review for-profit college applications for nonprofit college status and identify risks of improper benefit, according to agency officials. This team was involved in a recent Education determination regarding a for-profit college's application for nonprofit college status, which included a detailed consideration of the fairness of the sale price, a former owner's continuing role in the college, and the independence of the college's board, among other things.³¹ As a result of these and other actions, we found that Education was better positioned moving forward to thoroughly evaluate for-profit college applications for nonprofit status and mitigate the risk of improper benefit.

Our December 2020 report also found that for-profit colleges advertised as nonprofit colleges while Education was reviewing their applications. Specifically, the nine colleges with pending applications for nonprofit college status at the time of our review had all advertised as nonprofit colleges. We also reviewed past advertising for three additional colleges with available information—one of our three Education case study colleges and both colleges whose applications Education later denied—and found that all three had advertised as nonprofit before Education had made a decision on their applications.³² One college issued a press release the day after it obtained tax-exempt status from IRS—and three years before Education approved its application—stating that it was now a nonprofit tax-exempt educational institution whose conversion had been

³¹While this was not one of our three case studies with Education approval, we reviewed a public letter from Education that provided a detailed description of its denial decision. Its review noted that the terms of the contract for the nonprofit college to purchase a range of services from the former owner would benefit the former owner and stakeholders—which would be inconsistent with the Higher Education Act's prohibition against private individuals benefiting financially from a nonprofit college.

³²For the other two case study colleges with Education approval, we were unable to find advertising information corresponding to the periods during which their applications were pending.

conducted in accordance with "the requirements of the U.S. Department of Education."

As we noted in our report, some experts on student college choice suggested that students may want to consider whether a college is a nonprofit, for-profit, or public institution when choosing a college to attend, because a college's status can have different implications in terms of cost, perceived reputational benefits, and transfer of credits, among other things. If such a college advertises as nonprofit without being clear as to what this means, students may erroneously believe that the college is approved by Education as a nonprofit college—and, as a result, they may not have accurate information upon which to base their educational decisions.

Education officials acknowledged concerns about unclear language in colleges' advertisements while their applications are under review.³³ At the time of our review, Education had recently developed instructions to prohibit for-profit colleges with pending applications from advertising as nonprofit colleges and officials said that they planned to provide these instructions to all for-profit colleges that apply for nonprofit college status. As of March 2021, Education officials told us that they had provided these instructions to five of the nine colleges with pending applications, and planned to provide the instructions to an additional college as part of a document request in the near future. According to Education officials, of the three remaining colleges, one had closed and the other two have pending decision letters that will be issued in the near future and will contain advertising instructions, as appropriate. Providing these advertising instructions to colleges should help Education curtail this type of potentially confusing advertising and help ensure that students have clear and accurate information upon which to base their educational decisions.

³³Education officials noted that the agency cannot restrict colleges from referring to their tax-exempt status conferred by the IRS. Federal student aid regulations prohibit colleges from engaging in substantial misrepresentation in their marketing and advertising. See 34 C.F.R. § 688.71(b). We did not conduct a legal analysis to assess whether the advertising of any college complied with these regulations because we focused on Education's efforts to identify and respond to the risk of improper benefit.

After Approving Conversions, Education Did Not Review College Financial Statements to Identify Potential Risk Indicators for Improper Benefit among Converted Nonprofit Colleges

As we reported in December of 2020, some indicators of potential improper benefit may surface in a college's audited financial statements after Education has approved the college for nonprofit status; however, Education did not use its existing reviews of college financial statements to assess this risk.³⁴ Colleges are required to disclose information in their audited financial statements that can provide Education with important insights into possible improper benefit. For instance, in accordance with accounting standards, colleges must disclose related-party transactions, such as leases or contracts with insiders, as well as related-party debt. However, when Education staff reviewed a previously for-profit college's audited financial statements, they did not assess whether the statements contain indicators of potential improper benefit—even if the college is newly converted and participating in federal student aid programs under provisional authorization, a time during which they should be monitored more closely.³⁵

We reviewed audited financial statements for each of our three case study colleges approved by Education for nonprofit college status. In two cases, we found information in the colleges' audited financial statements that could raise concerns about possible improper benefit. For example, one college advanced funds to another business controlled by its former owner and later purchased assets from that business, all while the former owner continued to lead the college as its president. This college's financial statements also showed that the college, whose purchase price consisted almost exclusively of intangible assets (such as goodwill, accreditation, and established student relationships), recognized a substantial loss on those assets just a few years later.³⁶ While a substantial loss on intangible assets may arise for unforeseen reasons (i.e., shifting market conditions), it could also indicate that the college and its assets were knowingly overvalued at the time of the sale to improperly

³⁴The Higher Education Act requires all colleges to submit their audited financial statements to Education on an annual basis, and Education uses information in those statements to calculate the colleges' financial responsibility composite score, a measure of college financial health.

³⁵According to procedures, after Education's approval newly converted nonprofit colleges are provisionally authorized to receive federal student aid funds generally for a period of 1 to 3 years.

³⁶Intangible assets are inherently difficult to value. In general, purchasers pay the current perceived value of owning intangible assets, taking into account expectations about future performance.

benefit insiders.³⁷ Education staff in the region that managed this case told us that they were aware that the college had recognized a loss on intangible assets (as it had affected the agency's evaluation of the college's financial condition). However, staff also said that they had not considered whether the loss reflected a risk of improper benefit.

At the time of our report, Education had not developed plans to assess the financial statements of newly converted nonprofit colleges for indicators of possible improper benefit, even though we found they may contain new and relevant information about potential risks. Education officials stated that it would be reasonable for the agency to do so as a part of its annual audited financial statement review process. Officials further said that they could develop relevant procedures to ensure that such a review occurs and that identified concerns are provided to Education's centralized review team for further evaluation.

Without procedures in place for reviewing audited financial statements to look for indicators of improper benefit at newly converted nonprofit colleges, we found that Education lacked reasonable assurance that federal student aid funds are used appropriately and do not improperly benefit insiders. Standards for internal control in the federal government state that agency management should design control activities to achieve objectives and respond to risks.³⁸ As a result, we recommended that the Secretary of Education develop and implement monitoring procedures for staff to review the audited financial statements of all newly converted nonprofit colleges for the risk of improper benefit. In its written comments, Education agreed with the recommendation and stated that it will develop new financial analysis procedures to ensure that staff review audited financial statements submitted by newly converted colleges after Education's approval.

As of March 2021, Education reported that it is in the process of creating a new financial analysis division; once the division is operational, it will develop operating guidance that will include annual monitoring

³⁷One case study college whose sale price consisted almost entirely of intangible assets later claimed a substantial loss on those assets, citing a less optimistic regulatory outlook than previously anticipated, among other factors. Officials from this college stated that after engaging experts and performing its own study, the college reduced the value of intangible assets on its balance sheet, as required by generally accepted accounting principles, and reported a corresponding loss on its income statement, recognizing that the value was impaired.

³⁸GAO-14-704G

procedures for colleges whose conversions have been approved. Until such procedures are in place and are implemented for all newly converted nonprofit colleges, Education may miss opportunities to more effectively monitor newly converted nonprofit colleges.

In summary, my testimony has highlighted that for-profit college conversions involving insiders can pose risks to students and taxpayers. If a nonprofit college's revenues are diverted to improperly benefit insiders, funds available to support the college's educational mission would be reduced, potentially harming the college and its students, and violating federal requirements. IRS and Education each play an important role in ensuring that individuals do not improperly use the resources of a tax-exempt college for their personal benefit and we have identified opportunities for both agencies to improve their oversight in this area.

Chairman Scott, Republican Leader Foxx, and Members of the Committee, this completes my prepared statement. I would be pleased to respond to any questions that you may have at this time.

GAO Contact and Staff Acknowledgments

If you or your staff have any questions about this testimony, please contact Melissa Emrey-Arras, Director of Education, Workforce, and Income Security, at (617) 788-0534 or emreyarrasm@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. GAO staff who made key contributions to this testimony include Michelle St. Pierre (Assistant Director), Ellen Phelps Ranen (Analyst-in-Charge), Rachel Beers, Kelsey Kreider, and Caitlyn Leiter-Mason. Additional support was provided by James Bennett, Elizabeth Calderon, MacKenzie Cooper, Swati Deo, Holly Dye, Amy MacDonald, and Adam Wendel.



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Chairman SCOTT. Thank you. Thank you. Now we'll have questions from Members.

Under Committee Rule 9(a), questions will be by the five-minute rule. I'll be recognizing committee Members in seniority order. Again, to ensure the five-minute rule is adhered to, staff will be keeping time in the timer 001—timer. I will now recognize Mr. Grijalva first for questions. Mr. Grijalva.

Mr. GRIJALVA. Thank you very much Mr. Chairman and thank the witnesses and thank you for the hearing. Ms. Cao, the Century Foundation and specific to an issue here in Arizona, but I think indicative and representative of issues across this country.

The Foundation has recently written about the University of Arizona's plans to purchase Ashford University following that college, Ashford's failed non-profit conversion attempt. Can you walk us through your key concerns about that deal?

Ms. CAO. Sure. I think this is a great example and thanks for the opportunity to discuss Ashford's conversion into a non-profit entity called University of Arizona global campus. So, this is a particular dangerous form of a conversion where you have a for profit entity that has been under investigation and is currently approaching a trial from the California Attorney General's Office for misleading and predatory tactics used to recruit students.

Ashford University is also a school that spends very little of student's tuition dollars that come from Federal loans, student loan debt and military benefits on its student's instruction. It's something about 18 cents per dollar received in student tuition dollars. This is a conversion that would help Ashford's shareholders, but not necessarily the students who would be brought into the new University of Arizona global campus.

And part of the reason here is that the conversion keeps in place Zovio's shareholder's ability to extract profits from student's tuition dollars. In particular, we have conducted an analysis that shows over 70 percent of revenues coming in from student's tuition dollars will be going to Zovio shareholders after the conversion.

So, every dollar of debt that a student takes on, 70 cents going to Zovio shareholders. And that would occur through a contract that is a long-term service contract that keeps in place the aspect of Zovio's practices that is the most predatory, and that is the way that it advertises, markets, recruits, and takes out student loans for students.

And I think that is a huge concern. I also want to look at the other side of the equation in this conversion which is the University of Arizona itself.

Mr. GRIJALVA. Yes, I was going to ask about that.

Ms. CAO. Yes, so going from a situation where there is one revenue extracting entity, Zovio, to a situation where you now have two revenue extracting entities—Zovio on the one hand and University of Arizona on the other hand which yes, needs more resources as a public university.

But I argue the way for the University of Arizona to balance its budget is not off the backs of low-income students. With these for-profit conversions that involve public institutions, I fear that we are veering toward a system of separate and unequal units or affiliates within public institutions.

And not only is the University of Arizona and the University of Arizona global campus separate and unequal, but you have a situation where the low-income, minority, and non-family supported students at the University of Global Canvas are in fact subsidizing their much more privileged peers, who are already receiving a greater benefit from the education at University of Arizona, which because it is subject to genuine non-profit oversight, it's returning far greater value to students already.

Mr. GRIJALVA. Yes, which begs the question about the light touch review that the Department of Education gives on these conversion

partnerships between a public entity non-profit, Grand College at the University of Arizona, and a former for-profit college, Ashford.

Any safeguards that you see and that light touch review process so that we don't end up with both the student burden that you said very rightfully, issues of equity and higher education, and the taxpayer projects that are required for a tax supported institution like the University of Arizona.

Ms. CAO. Yes, so the GAO mentioned the Department of Education has started to improve its review of this conversion, and arguably it needs to continue the purpose. You know a tax-exempt status according to IRS is just one part of a three-pronged review the Department of Education will probably need to do.

And at the heart of that review is checking for the revenue extraction power that prior owners and other entities might retain.

Mr. GRIJALVA. Thank you very much. Thank you Mr. Chairman I yield back.

Chairman SCOTT. Thank you. Next is the Ranking Member of the Full committee Dr. Foxx.

Mrs. FOXX. Thank you, Mr. Chairman. And thank our witnesses. Ms. Emrey-Arras. To make sure it is clear could you please answer the following questions regarding the GAO report. Did your report find that Department of Education engaged in any illegal activity?

Ms. EMREY-ARRAS. No.

Ms. FOXX. Did your report make any determination or judgments about a particular school's conversion?

Ms. EMREY-ARRAS. We did not do an audit of any particular school.

Ms. FOXX. What was the Department of Education feedback to GAO regarding the project, and how did you address those comments in the report?

Ms. EMREY-ARRAS. The Department of Education agreed with our recommendation to it and said they will be implementing a recommendation.

Ms. FOXX. Is there anything illegal, generally speaking, about any for-profit company converting to a non-profit organization? Is there anything again, general speaking, about a for-profit college transitioning into a non-profit entity?

Ms. EMREY-ARRAS. No. For-profits are allowed legally to convert into non-profits.

Ms. FOXX. Right. Both in the education field and elsewhere?

Ms. EMREY-ARRAS. Correct.

Ms. FOXX. Thank you. Doctor Gillen one of the greatest benefits that college education provides students is better job prospects. Most students go to college to get a job. Unfortunately, many institutions are inadequately preparing students for post-college success.

Is this problem concentrated in any one sector, or is this an issue that is found in all sectors of post-secondary education?

Mr. GILLEN. So, our research has shown that this is a problem across higher education. Most of higher education of course performs very well, but there are many, many programs out there where student outcomes are not very good. And so, your question is you know is this concentrated among a particular sector and it's not.

So, we have a report coming out soon that looks at the debt to earnings ratio at all programs in the country. And there's about 4,500 of these where students graduate with more debt that they have expected earnings.

Ms. FOXX. And those are in public and not for profit schools?

Mr. GILLEN. Yes, so that's across the whole country, so about 4,500. And only between 4 and 500 of those are for-profits. So about 1 in 10 of problematic programs are located at for-profits, the other 90 percent are located at either public or private non-profits.

Ms. FOXX. Right. So, we're looking at 10 percent today when we ought to be looking at the 90 percent, really skewed. What other student outcomes should Congress consider attaching accountability metrics to, and should these accountability metrics evaluate entire institutions, or calculate outcomes on a program-by-program basis?

Now I know you've already mentioned some, but would you respond to those?

Mr. GILLEN. Yes absolutely. So, I think higher education can really benefit from explaining accountability metrics in two particular areas. So, the first is learning outcomes. So, for particular fields if we can figure out how to measure how much students have learned that would be a great accountability metric, as that is the entire purpose of these programs is to attach with their students.

That admittedly is difficult, but when it can be done, you should definitely try to. But the second one is earnings outcomes. And so, as you mentioned most students go to college to get a better job. And so, we can look at labor market outcomes to assess how well programs are preparing their students for that.

And so, I would really love to see learning and earning outcomes. And you mentioned what is to be applied at the institution level as for the entire university or at the program level and applying it at the program level is definitely the way to go and the reason for that is because you can have a badly performing program at a relatively good institution that escapes all accountability.

And you can also have the Congress. You can have a really good program at a relatively poorly performing university that if you do university level accountability, you're going to be punishing that good program. And so, if you can do program accountability you avoid both of those problems and you actually reward the programs that should be rewarded, and you punish the ones that should be punished.

Ms. FOXX. Well, I tell you I had that experience when I was the president of the community college. I eliminated a program that had been poorly performing for 10 years and put in a program that was desperately needed by the community. So, I've been through that, and I understand how that works.

Ms. Emrey-Arras does the department monitor either non-profits or publics for improper benefits—because you talk about improper benefits for those that have been converted, but I don't know anybody. I mean we're paying football coaches millions of dollars. We're paying presidents and provosts millions of dollars. Who is to say what is a benefit? And is anything happening with non-profits or publics?

Ms. EMREY-ARRAS. All right. So, for our work we did not look at executive compensation at schools. We did focus specifically on conversions of for-profit schools and did find concerns about the lack of monitoring of those schools. Those schools are subject to additional monitoring. After being approved they're in a provisional status.

Ms. FOXX. We understand that. So, Mr. Chairman I'd like to put into the record information on abysmal graduation rates for not-for-profit schools and public schools, specifically Thomas University, graduation rate of 14 percent after 8 years, a private institution. Harris Stowe State University 16 percent graduation rate after 8 years.

University of New Mexico Taos campus 13 percent graduation rates. There are some other items to put into the record report from AEI and higher education has a tax problem and it's hurting local communities. We'll be putting these into the record. Thank you Mr. Chairman I yield back.

Chairman SCOTT. Next is Representative Wilson from Florida.

Ms. WILSON: Thank you Chairman Scott and Ranking Member Foxx for holding this very important meeting. And I'd like to thank all of the witnesses for participating in the meeting today. Increasingly we have seen predatory for-profit institutions mislead the public and abuse their trust by illegitimately converting to tax exempt non-profit status.

These dubious conversions often seriously harm students and taxpayers and enrich the for-profit former owner and other private individuals. Congress must do more to hold bad actors to account and ensure that students can make informed decisions about their post-secondary careers.

Under existing law non-profit institutions are prohibited from improperly steering profits toward private figures. Unfortunately, in the case for profit converts this happens all too often. The Government Accountability Office found that conversions that involved the former owner or other executives accounted for 75 percent of all Federal aid that went to for-profit converts.

Clearly, too many bad actors are slipping through the cracks and this must stop. With that in mind I have a few questions for our witnesses. Ms. Cao what is the harm of students mistakenly believing that a school they're considering attending is mission driven, when actually it is still operating on a quasi-for-profit model?

And based on your experience surveying various for-profit conversions, would you say that the improper and harmful way they did this committee has been examining today is limited to only a few bad actors?

Ms. CAO. Thanks for the question. In terms of harm to students I think we need to start with all the risks for harm that already exist and are concentrated within for-profit schools. We're talking about high loan rates, high default rates, low earnings and a debt to earnings ratio that result in a life-long debt sentence for students.

Start with those results. Now strip away protections like the gainful employment tests, and the 90/10 rule, which help to provide some guardrails and protections for students, and some requirement for for-profits to demonstrate their value. Take those protec-

tions away. Now add in the opportunity for predatory institutions to mislead the students by touting their non-profit status.

These are institutions that are leveraging the charitable status of non-profits that are reinvesting their resources in order to benefit shareholders that will be extracting those resources. And that's the equation you have with these conversions. All of the risk of for-profit schools, none of the protections, and the added risk of being able to mislead students.

Ms. WILSON. Thank you. Director Emrey-Arras, the GAO issued two recommendations to the IRS. What, if any steps, has the IRS taken to implement those recommendations?

Ms. EMREY-ARRAS. Thank you. The IRS said that it is reviewing its process for approving applications for tax exempt status to decide whether or not any changes need to be made, and it is considering our second recommendation on gathering information in a way that it can be used to help with its monitoring.

Ms. WILSON. Can you explain to us why it is important for the IRS to collect information and to help identify tax exempt colleges with a for-profit history? Why is that so important?

Ms. EMREY-ARRAS. Well, the IRS itself has identified these organizations as at-risk for improper benefit. So, it has just said that organizations with the for-profit history are at an elevated risk of improper benefit. Given that it has created a compliance strategy to do monitoring of these schools, and the compliance strategy actually originated in concern over for-profit school conversions and then broadened beyond higher education.

However, ironically, they couldn't like even identify the schools in our study when they tried to do this compliance effort because they lacked the information in a searchable form. And to respond to an earlier witness statement about cost benefit issues I would say that the IRS has said that they're often collecting this information in narrative fields already.

So, the information is already being gathered. It's just not being gathered in a searchable way. So, there wouldn't be much of a cost in terms of changing the field from a narrative field to a data field that could be searched which would then give the IRS the information it needs to actually be strategic in its monitoring and monitor this risk that it's very concerned about.

Ms. WILSON. Thank you. I yield back Mr. Chair.

Chairman SCOTT. Thank you. Mr. Walberg.

Mr. WALBERG. Thank you, Mr. Chairman, and thank you to the panel for being with us today. Dr. Gillen I think we all agree that the top priority for higher education institutions should be serving students, and that those failing to do so should be held accountable.

I guess what I'd ask is what can the department do to improve accountability for all institutions and what can they not do because it is not within their authority?

Mr. GILLEN. That's a great question. So, the department right now has a lot of capability of providing more information in transparency. So, there are a number of data collection tools that are already used, and so the department can add information to IPEDS, the integrated post-secondary education data system.

It could add College Navigator which is a Department of Education website. It could add it to its College Scorecard which is another Department of Education website. And so simply providing more information to students, parents, policymakers, that is kind of the foundation of making wise decisions for everybody.

In terms of kind of actually enhancing accountability with carrots and sticks, at that point you would need you know this committee and Congress more broadly to pass legislation to authorize new accountability metrics. And as I mentioned earlier it would be great to see accountability metrics on learning outcomes, on earning outcomes and labor market outcomes more broadly.

Mr. WALBERG. I guess expanding on that what should Congress consider when we next reauthorize the HEA to protect students and taxpayers from fraud or abuse?

Mr. GILLEN. So, I think we should start with the data we already have which is the new college scorecard data, and so right now it's producing data on college earnings and debt by student. So, we can create, and we should definitely start with creating some accountability metrics that essentially look at earnings relative to debt.

So, are students able to afford to be able to repay their loans? Are programs consistently graduating students that are going to struggle with their student loans? And so, accountability metrics devoted to that would be great. I would also love to see different kinds of types of accountability.

So, you know the first level is this program achieving this level? And we can do that with the existing data. We can say OK, if you have you know twice as much debt as your students earn, we're going to cut you off on the total financial burdens. But I'd also like to see growth measures as well.

So, if you're taking students that are you know otherwise going to be really struggling in the labor market, and even if they aren't achieving at the top levels of the labor market after attending your program, if you've improved their kind of career trajectory by enough, that would be another great accountability metric.

So, I would love to see a plethora of these accountability metrics. You know we shouldn't just think in terms of this is you know the one and only accountability metric. There should be you know a dozen of these, and institutions can meet, you know, 8 to 10 of them and to maintain their eligibility for financial aid program.

Mr. WALBERG. A real education in the process. OK. Appreciate that. Ms. Emrey-Arras what factors does the IRS examine when determining whether any entity may convert from a for-profit status to non-profit status?

Ms. EMREY-ARRAS. It looks at a variety of materials that the tax-exempt organization submits, however we have concerns that it doesn't always look at the materials it needs to make that call. As noted earlier, we found instances in which the IRS approved applications for tax exempt status involving college conversions without the purchase price of the college, without an independent appraisal of the college.

So, there was no known information about the value of the college. Instead, there was just a promise. The applicant promised that in the future you know the market, the price would be a fair one. It would be a market value price, and they would get an inde-

pendent appraisal in the future. And with that promise the IRS approved the applications.

Mr. WALBERG. Can you point to a statute or code, or regulatory language that guides this process?

Ms. EMREY-ARRAS. I can point to IRS guidance that says that relationships between tax exempt applicants and for-profit entities may be vulnerable to abuse and need scrutiny to ensure fair market value, and organization earnings cannot improperly benefit private individuals over its charitable mission.

And that's what happens. If a college is sold above its fair market value, you have money improperly benefiting individuals in that case. And that is against the Internal Revenue Code.

Mr. WALBERG. Thank you. My time has expired. I yield back.

Chairman SCOTT. Thank you. The Gentledady from Oregon Ms. Bonamici.

Ms. BONAMICI. Thank you to the Chair and Ranking Member and thank you to all of our witnesses for being here today. First, I want to object to the suggestion that was made by Mr. Gillen to use income of an institution's graduates to measure accountability.

If someone is doing meaningful work at social services and earning low wages for example, that does not mean that they did get a good education, it likely means that their work is undervalued. As someone with a consumer protection background, I am very glad we're having this hearing today.

For-profit colleges have preying on students, families, often by making unsubstantiated claims of the value of educational opportunities they offer, and too many students have found out themselves, with tens of thousands of dollars in debt and no closer to the career they were working toward.

A few years ago, I had the opportunity and the honor of meeting with several military veterans in northwest Oregon who told me about how they were defrauded by for-profit colleges that had misrepresented accreditation, tuition, and services. They were targeted, these veterans, because they were eligible for GI benefits, which is a common practice among profit institutions.

And now unfortunately, as more students are coming to understand the predatory practices of so many for-profit institutions now as we've heard, some of these same schools are converting to non-profits, but too often is continuing to employ the same harmful practices that take advantage of students.

So, Ms. Cao it is clear that the Federal Government has not been conducting the necessary oversight to prevent these conversions, in addition to the problems from the conversions, and in addition to increased Federal oversight and accountability measures, what role can and should states and accreditors play in scrutinizing these conversions?

Ms. CAO. Thank you for that question. And I'm glad that you pointed out the impact that these conversions can have on veterans in particular. I want to recognize the progress that this committee and Congress has made in improving the protections in the 90/10 rule.

To Mr. Gillen's point about measuring both earnings and learning of students, we actually have that in the form of the Gainful Employment Protection, which measures earnings as a ratio

against debt, and we have that in the form of the 90/10 protections, which measure learning by leaving it to the market to determine whether the learning that happens within an institution is worth the cost.

And so, we actually have both learnings and earnings measured within the for-profit sector, but what we have seen time and again is that instead of doing the hard work to demonstrate learning and earning of value in their institutions, the most predatory schools choose to cheat by seeking disingenuous conversions to non-profit status.

And yes, there are states that are stepping up to address the problem. Both Maryland and the State of California have enacted legislation that authorizes the states to engage in a closer look of insider benefits in the same way that the GAO has pointed out that the IRS and the Department of Education should do.

I am worried about the problem that Professor Galle talked about earlier where you have too many kids running toward the ball and it falling through the cracks in the process.

Ms. BONAMICI. Thank you. In fact, I'm going to ask Professor Galle. I've worked for years on collaboration between the IRS and the Department of Education on the issue of verifying income for income-driven repayment plans. And when you used your analogy, I'm not going to be able to get that out of my head now.

I'm thinking about you know trying to coordinate between the two agencies. Should it be that the coordination between the IRS and the Department of Education on for-profit conversions and if so what kind, or is that kind of coordination really achievable based on how you understand the agencies to operate?

Mr. GALLE. Thank you for that question. I think that some more coordination would certainly be helpful. And there's some small legal obstacle to a full coordination in the sense the IRS is very limited in what kinds of taxpayer information it's allowed to share.

And although it is allowed to share taxpayer information for purposes of verifying income driven repayment eligibility, it's not clear that the IRS can share information about whether it's audited a for-profit institution with the Department of Education.

But I think more generally the real story here is that ED needs to take the lead and in protecting student interests. It's not the IRS's primary mission. It's not their primary interest, and the statutory authority that IRS is working under doesn't really lend itself to identifying schools that are protecting their own bottom line over the student interest.

Ms. BONAMICI. I appreciate that. We are policymakers though, and if the policy doesn't exist that's what we want to hear about. That's one of the purposes of having a hearing like this, so I thank you Mr. Chairman, and I yield back the balance of my time.

Chairman SCOTT. Thank you. gentleman from Wisconsin Mr. Grothman.

Mr. GROTHMAN. Thank you. I have a few comments here not directly at anybody in particular because I know there are obviously people out there who are hostile to the idea of a conversion, but of course I know some people or some conversions I think were done for the best of reasons. And I think the idea of making this in essence against the law is a huge, a huge mistake.

Do you all agree that there are for-profits converting to non-profits and that it's working out well and there aren't abuses?

Ms. CAO. I just want to point out I don't think that any of the witnesses are saying that a for-profit college converting to a non-profit status is against the law. Having pointed out the risks associated with for-profits that engage in revenue extraction, I would love for for-profit colleges to convert to true non-profit status with a commitment to reinvesting 100 percent of revenue in educational and charitable purposes.

The concern is not for-profits converting to non-profit status, it is for-profits claiming that they are non-profits without doing the hard work of actually reinvesting resources in students.

Mr. GROTHMAN. I guess the question is because I don't know if it's a minority or majority, but there's certainly many, probably a majority when they convert for the best of reasons OK. You may convert for succession reasons OK. You like your college. Your children or whatever are not going to continue down the path, so you switch to make it a non-profit.

You may have a situation in which you have a nursing degree, and we have a real shortage of nurses in this country, and in order to establish a coalition with local medical facilities, you're required to go a non-profit, so for the benefit of your nursing students you go a non-profit.

You can do fundraising, obviously if you become a 501(c)(3) you can fundraise just like public universities can. And I guess I want to get you folks on the record that these are all three good reasons to convert, and you do not want to prevent these conversions with some legislative bill.

Can you see the reasons all these three reasons why they are good reasons why you want to convert?

Ms. CAO. Those are excellent reasons for conversion, and if any for-profit school pursues conversion for those reasons, and prohibits insiders from extracting benefit for private gain, then I absolutely support those, and I'll turn to the rest of the witnesses.

Mr. GROTHMAN. OK. Could everybody else be on record as saying that there are good conversions, these are good reasons to convert and there are ways in which we keep capped light successful currently for-profit colleges going?

Mr. GALLE. I would describe those scenarios Congressman as hypotheticals. I didn't see any of the—

Mr. GROTHMAN. They are not hypotheticals, why do you believe—I could think of an example where they do this right now. Why do you feel it's a hypothetical?

Mr. GALLE. Well, based on my reading of the GAO report in which the vast majority of for example, the government subsidized money going to converted organizations, is going to organizations where the former owner is still keeping the supposedly converted organization a prisoner of their obligations to the original owner.

There's no way for these organizations to operate in the way that other non-profits genuinely operate. And if you wanted to really transition and the organization to operate the way that non-profits do, you would free it financially to maximize student outcomes instead of student revenues, and that's just not what this contract said.

Mr. GROTHMAN. OK. Any other comments?

Mr. GILLEN. Yes. So, all those kind of reasons to convert are completely valid. There's tons of conversions out there that I don't think anybody would object to. The other thing I'd like to point out is that all the concerns that have been raised here about improper benefit, that's already forbidden by both the IRS and the Department of Education.

And so, this whole issue is whether the Department of Education and the IRS procedures are adequately detecting any sort of hypothetical improper benefit. But improper benefit has not been shown in any of the approved cases, and the Department of Education has denied some of these conversions. So, I feel like some of the comments have been taking place assuming that there's this huge problem, when it's more of a hypothetical problem at this point, or a yet to be proven.

Mr. GROTHMAN. I agree. I think there's just some people who are instinctually hateful of an educational institution that isn't part of the government, and as the result they risk throwing out some very good former for-profits. Now if I have any time left, I guess Representative Foxx wants to ask a question.

Ms. FOXX. Thank you, Mr. Grothman. I would point out that OK. Never mind, I believe Mr. Grothman's time is up.

Chairman SCOTT. The Gentleman's time has expired. The Gentleman from the North Mariana Islands Mr. Sablan.

Mr. SABLAN. Yes, thank you very much Mr. Chairman, and thank you to our witnesses. I apologize I'm jumping between two committees, two committee hearings. So, I am going to just go out and ask a question for Ms. Cao. Ms. Cao please.

Ms. CAO your organization wrote about two conversion transactions—The Non-profit Center for Excellence in Higher Education's purchase of four for-profit colleges owned by Carl Barney and the non-profit Everglades College's purchase of the for-profit Keiser University, which involved the college's former owner donating part of the college price to the non-profit purchaser, enabling them to take hundreds of millions in tax deductions.

GAO also mentioned the phenomenon of former owners donating part of their college sale price back to the college. How do you interpret these potential charitable donations from the goodness of their heart? Are they truly charitable? Are they truly from the goodness of their heart?

Ms. CAO. Thank you for your question. I want to take a good close look at some of these charitable donations when for-profit schools convert to non-profit status because the schools that you identified come with some real concerns.

CEHE, the Center for Excellence in Higher Education, the individuals for the insiders who benefited the most from those conversions were recently found personally liable for operating years of systemic fraud against both students and the Title IV system, drawing down student revenue while misrepresenting to them the benefits that they would get from it.

Misrepresenting the amount of tuition, the likelihood of success, and whether or not the programs would ever lead to gainful employment in their fields of study. That type of behavior is indicative

of the predatory nature of those institutions, as is the way that those conversions were structured.

So, I want to take a look at the way that those conversions were structured because it was a very similar situation in both the CEHE and Keiser instances. You had a conversion that allowed the insider to continue extracting resources through two primary mechanisms—ongoing rent payments, and ongoing loan payments. So, you have an institution that remains in debt to its former boss who continues to hold the reins on the institution by being able to guide decisionmaking through these two contracts that puts the non-profit at a huge disadvantage.

As for the reported donations, they are donations of intangible benefits. So, to take one of the examples, the Keiser University example. The original purchase price was 90 percent intangible assets, which the Department of Education does not permit institutions to report on their audited financial statements.

So, you have about 60 million dollars of real tangible assets, and you have a non-profit promising to pay 600 million for it. Of course, some of that 600 million gets donated for a tax credit, but you still have a non-profit being obligated to pay through an ongoing debt obligation, significantly more than the value of the real assets that they are obtaining.

Mr. SABLAN. So, after they cheated the parties, they have to just might as well make it three then. That's shortchanged the American taxpayer from avoiding taxes. Ms. Director Emrey-Arras.

Ms. EMREY-ARRAS. Yes.

Mr. SABLAN. Director can you tell me about how the value of the for-profit college was determined in the cases the GAO reviewed, where the transaction involved insiders? Was it based mostly on tangible assets like cash, investment, and property?

And how does this compare to some of the conversions you looked at that didn't involve insiders? Half a minute.

Ms. EMREY-ARRAS. So, for our case studies we found that those with insiders purchased mostly intangible assets, so goodwill, brand name, accreditation—things you can't touch. It's not money in the bank. It's not property. And in contrast when we looked at five randomly selected conversions without insiders, they mostly purchased tangibles, things that you could touch, cash, investments, property, so there's a real difference there.

Mr. SABLAN. Thank you. I again thank the witnesses today. Mr. Chairman I yield back.

Chairman SCOTT. Thank you. The Gentleman from Idaho Mr. Fulcher.

Mr. FULCHER. Thank you, Mr. Chairman. And I'm intrigued by this conversation on the valuation and Mr. Gillen you've touched on this, but I'd like to get a little bit of further thought on that. How does the HEA assess financial well-being of these institutions? And talk about that just for a minute, and do the measurements they use reflect accuracy and comprehensiveness of these institutions? Mr. Gillen please.

Mr. GILLEN. So, the Department of Education has a number of financial tests that institutions are subject to. The report itself talks about the financial composite score. There's a few others, the

asset test, and so these are you know existing tests, financial tests that institutions have to pass.

These are mostly looking at the kind of cash-flow health of the organization. They aren't really looking at the long-term sustainability. And so, one of the issues this raises is things like these intangibles are not included in those because those don't show up on you know a cash-flow statement.

And so, you can have a lot of situations as the GAO report pointed out where you're using debt to purchase these intangibles. On paper that's going to make your financial evaluation deteriorate because the debt is showing up, is affecting your cash, but the intangibles don't. And so, there's a lot of kind of questions about that.

Mr. FULCHER. So, there is kind of a composite score it sounds like that is partly formulated. So, in that sense do you feel like that that's a reasonable predictor of whether or not a college might close for example? The way it's gauged right now by the AGA?

Mr. GILLEN. So, my understanding just based on the number of colleges who have closed for primarily financial reasons is that these tests that the Department of Education subjects them to will catch most of the schools that are just going to run out of money. And so, it will kind of catch schools that are essentially already bankrupt.

But it's not very predictive of schools that are going to become bankrupt. And so, these are tests that will catch, and are designed to catch kind of the kind of worst financial shape schools, but there's a bunch of other schools that are struggling financially. Maybe they're not going to go bankrupt this year or next year, but their long-term sustainability is just really in question.

And these tests aren't going to catch that, and they're not really designed to.

Mr. FULCHER. Thank you, Mr. Gillen. So just one more follow-up. I think I still have another minute. Let's talk places you know mainly familiar, if you were on this committee and you were going to reshape how the current law is in order to better assess or improve the calculation of the value, what would you recommend?

Mr. GILLEN. The value of—

Mr. FULCHER. Of the institutions, the assessment structure.

Mr. GILLEN. So, I would really try to tailor accountability mechanisms to the specific program at hand. And so, for things like the student loan programs, where the government is providing this loan money to students, and so we should really be tailoring the accountability metrics for that program to loan outcomes.

So, our students are able to be repay their loans would be kind of top of mind on that. But that isn't necessarily the same accountability program we'd want to use for say, Pell grants. Pell grants are designed to increase social mobility and equality of opportunity, and so we may not necessarily want to use those same labor market outcomes to evaluate Pell grants.

Mr. FULCHER. Got it.

Mr. GILLEN. We would want to focus more on graduation rates for Pell grant recipients. And so really just I would encourage the committee to think about what would be the most appropriate accountability metric, or metrics for any given program that we're looking at.

Mr. FULCHER. Good. Thank you. Mr. Chairman if I have any remaining time, I will yield that to Dr. Foxx.

Ms. FOXX. Thank you. I want to thank the Gentleman. You know there are lies, damn lies, and statistics. So, an interpretation of numbers means something. In the 2017–2018 school year private for-profit colleges spent an average of 27 percent of their finances on instruction.

Compare that to public schools which spent 29 percent of their money on instruction, private non-profits 31 percent. But the real kicker is in academic support. Private for-profits spent 63 percent of their money on academic support for students, and for public's and private non-profit only lower than 30 percent went to academic support.

And we know that the for-profit schools are taking in students that the public's and the not for-profit don't want. They are the toughest students to teach, and yet they're giving them the kind of support that they need. So, the interpretation of numbers is very, very important here, and we will be submitting this for the record Mr. Chairman.

I think it's very important that we get these things in the record. Thank you I yield back.

Chairman SCOTT. Thank you. And before I recognize Mr. Takano, I'm going to ask for Mr. Sablan to assume the Chair for several minutes. I have another commitment, so I'll be back in a few minutes. The Gentleman from California Mr. Takano.

Mr. TAKANO. Thank you, Mr. Chairman. I would dispute those statistics. I know in California the public institutions of higher education actually are required by law to spend at least half of their revenue on instruction and cannot spend it on administration.

And furthermore, I think it's quite often the case that for-profit institutions do not have really admission standards. And you can reinterpret that to mean that they're taking students that other institutions don't want, but I would dispute the idea that they're taking students that have developmental educational needs and are really delivering on that.

Ms. CAO can you clarify something for me and the public? Is it true that borrower defense and the 90/10 rule do not apply to non-profit institutions? They're only for for-profit institutions?

Ms. CAO. No. That's borrower defense and the gainful employment rule apply to all institutions. It is just the case that 99.7 percent of borrower defense claims that have been submitted because students feel that they've been defrauded, reflect behaviors at for-profit and covert for-profit institutions.

Mr. TAKANO. What about 90/10? Does 90/10 apply to non-profit institutions? The studies that apply to non-profit institutions the 90/10 rule

Ms. CAO. The 90/10 rule applies to for-profit institutions and sometimes to recent conversions.

Mr. TAKANO. OK. I'm seeing Ms. Emrey-Arras shaking her head. 90/10 does not apply to non-profit institutions.

Ms. EMREY-ARRAS. Correct. With the only exception being the reference just made previously that for the year after conversion is approved from a for-profit to a non-profit, they are still subject for

that 1-year period to 90/10. But other than that, non-profits are not subject to 90/10.

Mr. TAKANO. But Ms. Cao do we know of non-profit institutions that receive 90 percent or more of their revenue from the Federal Government?

Ms. CAO. So, I can think of two conversions within the last 20 years that might present this scenario. So, one is the case of Wright Career College which back in the 90's when the 85/15 precursor to the 90/10 rule was enacted, they told the IRS we're going to go ahead and convert to non-profit status because we want to avoid the accountability of the 85/15 rule. The other one is a recent example.

The Dream Center Schools told an accreditor that they wanted to obtain non-profit status for their revenue extracting schools so that they could avoid the 90/10 rule and avoid gainful employment programs. And they said avoiding these regulations will help us operate more efficiently, and of course that efficiency ran those institutions right into the ground.

Mr. TAKANO. Well, thank you. Thank you, Ms. Cao. Mr. Galle would you give Department of ED the ability to audit non-profit educational institutions that receive Federal money, or lots of Federal money? Would that be part of the solution given enough authority to add to be able to properly oversee non-profits?

Mr. GALLE. Thank you, Congressman. I think ED already has that authority. The statute obliges Ed to decide whether an organization is a non-profit or public, or proprietary, which means for-profit school.

And regulations explain how ED does that. You know it looks at whether IRS has treated the organization as a charity, but then independently ED regulations say ED has to decide whether the organization is providing a nexus of benefit to any private party, which usually means it's giving too much money to its insiders, or it's a prisoner of its debts, or if it's a risk contract.

And so, it's already ED's obligation under existing regulations in my view to make sure that organizations are really protecting students and not their bottom line.

Mr. TAKANO. Would you give ED some role in the vetting process of conversions? In other words, IRS establishes that they can become a non-profit, would you insert ED into that process and give them some sort of role in the vetting?

Mr. GALLE. So, I think it's appropriate for IRS to decide which organization face which tax consequences. It's mostly not IRS's view of their job to decide which organizations are fully charitable or not. Back in the 90's Congress found that IRS wasn't really willing to do that job. They weren't willing to impose the death sentence on organizations, then take away their charitable status, or refuse it in the first place.

So, IRS only imposes this thing called an intermediate sanction, which is kind of a penalty tax on people who extract money from their organization. So, IRS is really just not in the business of figuring out who has the incentives to protect students and who doesn't.

And so, I think it makes more sense for Ed to fulfill that test, because that's their statutory and regulatory mission.

Mr. TAKANO. And that's how you would change the law.

Mr. SABLAN. Thank you.

Mr. TAKANO. Thank you, Mr. Chair.

Mr. SABLAN. Thank you. Now I would like to recognize Mr. Allen of Georgia please, 5 minutes.

Mr. ALLEN. Thank you, Mr. Chairman, and obviously this is a very partisan issue that you know our Democrat friends make clear that they want to dismount profit education. I think probably the reason that profit institutions exist is because of what is being taught at public institutions, and the American people want a choice.

The fact is that many students, including non-traditional students and veterans, choose their schools because those schools fulfill what they are looking for out of college. Dr. Gillen what are some of the distinguishing features of for-profits schools as compared to their peers in the non-profit and public space? And I'm referring to schools like Prager U and other schools like that teach you know civics and you know amongst the country and those kinds of things. And do they offer different programs or more flexibility?

Mr. GILLEN. Yes, great question. The for-profit sector historically has been rather innovative. And so, we've seen a number of practices that may have been you know, tried to scatter shot here and there, but they really became standard practice in the for-profit sector.

So, helping students fill out the FAFSA was kind of an innovation that really scaled up within the for-profit sector. Allowing nighttime classes for students who are working full-time, they didn't quit their job to go to school during the day, and so offering nighttime and weekend classes was really a specialty of the for-profit sector.

And it's spread to some other institutions as well. And really the main advantage of the for-profit sector I think is this kind of experimental lab of how can we improve kind of the educational offerings?

Mr. ALLEN. Right.

Mr. GILLEN. And I'll throw online education in there. For-profits embraced online education very early, and as we just saw with COVID everybody had begun.

And so, before the for-profits have sort of kind of experimented with the process a lot more, it wasn't as rough as a transition for everybody else because we had seen what online education does and how they do it.

Mr. ALLEN. And so, this flexibility is critical. Students assume risk when they take out loans and the Federal Government taxpayer assumes risk by lending that money, but the institution, the one arguably benefiting the most from this arrangement, does not have any direct risk in the Federal student loan program.

And in your opinion should colleges and universities have more skin in the game? If so, what are some of the ways we can incorporate institutions in the Federal student loan program?

Mr. GILLEN. Yes, I think skin in the game ideas make a lot of sense as long as we're restricting ourselves to the current loan system where the government is the lender. So, if we were not in the

situation where the government was the lender, where we had private lenders, there would be no reason for skin in the game because the lenders themselves would be doing their due diligence on whether this is a wise one to be making.

But both the government and the institutions under the current system our government is under don't have any desire to do their due diligence on these loans, and so you can—we do have a lot of programs that are consistently allowing students to over borrow.

And so, one solution to that is skin in the game proposal. And there's a lot of different ways those can be structured, and so one kind of proposal that was tried in Chile was to hold universities responsible for the debt of dropouts. Now we need to be very careful though just replicating that, because one of the things they found in Chile was that this resulted in lower quality of their schools because the schools, knowing that they would be responsible for the debt of dropouts, lowered their standards so more students would graduate, they would have less dropouts.

So, we need to be very, very careful in designing the skin in the game proposal, or a risk sharing proposal, but as long as we're in kind of the current status where the government's lending, and they're lending pretty indiscriminately, then some sort of skin in the game or risk sharing proposal I think within proprietors.

Mr. ALLEN. Well, most of the young people that I've talked to about their student loan debt have admitted to me that they had no idea of what they were getting into. And they had no idea how they were going to pay it back. And that's why I had an amendment on the Higher Education Act to make sure they got proper financial counseling. I thank you and I yield back.

Mr. SABLAN. Thank you very much Mr. Allen. I now recognize Ms. Adams of North Carolina for 5 minutes.

Ms. ADAMS. Thank you, Mr. Chair, and I appreciate the opportunity to participate in this hearing today. Director Emrey-Arras, do most conversions involving existing non-profit college with long-standing experience in running a school, taking over for-profit college. And let me repeat that.

Do most conversions involve an existing non-profit college with long-standing experience in running a school, taking over the for-profit college?

Ms. EMREY-ARRAS. The answer is no. Of the 59 conversions that we saw there were only five involving an existing non-profit college.

Ms. ADAMS. OK. So, what kinds of non-profit organizations are purchasing these for-profit colleges?

Ms. EMREY-ARRAS. They can be an array of organizations that don't necessarily have experience educating students. We found a scholarship fund, a professional association, a private foundation, and others. So, you have an assortment of non-profits and as we've stated these are not existing non-profit colleges assuming the for-profits.

Ms. ADAMS. OK. So, they may be newly created non-profits being used to engineer these conversions?

Ms. EMREY-ARRAS. Certainly. Of the 59 conversions we found that nine involved completely new non-profits that had no activities prior to the purchase of the for-profit school, and they were more likely to be involved in the insider conversions. So, the conversions

without insiders involved almost always existing non-profits that had been established previously, while about half of the insider conversions involved completely new non-profits that had no prior track records.

Ms. ADAMS. OK. So, what does it mean for protecting the best interests of students then?

Ms. EMREY-ARRAS. Well, I think there's a difference when you have an existing non-profit college take over a school versus a foundation or a scholarship fund take over a school. So, I think there's a difference in terms of the educational experience that is brought to bear.

Ms. ADAMS. Right. Thank you. Professor Galle what does a traditional non-profit college board look like?

Mr. GALLE. Usually a non-profit college board is a group of experts and community Members who volunteer their time. Many of them are large supports of the institution. They might be alums or other donors. They're not typically paid for their time. They have no financial interest in the ability of the organization to pay profits to its service provider, or the former for-profit that it owes a huge IOU to.

That is not true of several of the boards that I examined after reading the GAO report. For example, there's one board where the board Members receive about \$300.00 an hour for their time as a board member, which is far outside the norm, and certainly you can imagine affects their incentives to go along with the financial interests of the people who they participate with.

Ms. ADAMS. OK. So, when an insider is retaining some or all of the same leadership roles post-conversion, how does it affect the ability of a college to function as a true non-profit?

Mr. GALLE. I mean it's impossible. First of all, just talk about legally you have a so-called fiduciary duty, you have a legal obligation to look out for the interests of an organization that you're the head of. It's impossible for someone like Brian Miller, who runs both GCU and it's for-profit parent to follow the law in both cases, right because you owe a duty to the non-profit to pay as you know, to get as good as a price as you can from your contracting partner, but you also have a duty on behalf of the contracting partner that you're running to get as much money as you can out of the non-profit, there's just no way to do both.

Ms. ADAMS. OK. Mr. Chairman I wish to submit for the record a letter from the National Association of Independent Colleges and Universities in support of Federal oversight for non-profit conversions to ensure integrity in these processes and with that Mr. Chairman I'll have to yield back.

Mr. SABLAN. All right. Without objections it is so ordered.

Mr. SABLAN. Now I recognize Mr. Keller of Pennsylvania. Sir you have 5 minutes.

Mr. KELLER. Thank you, Mr. Chairman. I believe we can all agree that the government should hold all post-secondary institutions accountable for the benefit of students and taxpayers alike. At the end of the day higher education is as diverse because students are diverse, think differently and learn differently.

Pennsylvania has colleges, universities, technical schools, vocational programs, and other types of schools, all designed to get

their students ready for the workforce. I hear firsthand how important a qualified workforce is for Pennsylvania's 12th congressional District.

No matter what industry we talk about, employers are struggling to find qualified workers. Regardless of what industry or type of college we're talk about, it's clear to me that educational programs should be evaluated based on outcomes achieved by and for students.

So, my question is that for Dr. Gillen, thank you for your testimony and for being here today. What can the Department of Education do to improve accountability for each institution under its purview, and what does Congress need to do to give them proper authority in the interest of maximizing accountability?

Mr. GILLEN. That is a great question, and we can spend you know many, many hearings, specifically on that topic. One of the big obstacles I think to seem kind of impermanent in higher education is actually the accreditation system. And so, one of the problems with the way accreditation which is all universities are required to have accreditation in order to participate in the Federal financial programs.

And the accreditation rules typically kind of mandate the inputs and the processes that universities need to follow. And so, if you're mandating the inputs on the processes, you're essentially sort of already you're basically saying you can bake whatever cake you like, but you have to use this chocolate cake recipe right.

So, it's no surprise that we end up getting you know a lot of chocolate cakes. Or maybe we need vanilla cakes. Maybe we need you know Korean tacos. Like there's a lot of innovation that should be happening in education right now that we aren't seeing because the accreditation system is a barrier to that innovation.

So, I would really like to see what I call escape hatches, introduced them into accreditation. So, accreditation is really kind of a one size fits all solution, and so instead of mandating accreditation for everybody, we can introduce escape hatches.

So, for more vocational programs we could have a labor market outcome serve as an alternative to accreditation. So, if enough of your graduates are graduating and getting you know really, really well-paying jobs, that can serve as a form of accreditation for financial aid purposes.

We can also do this with learning outcomes. So, for law schools you know if 95 percent of your students are passing the bar exam, you don't really need accreditation. We know you're doing a good job. And so, introducing these escape hatches would allow programs and institutions to innovate on the inputs in the processes, because we're more directly measuring the outputs and the outcomes.

So, accountability should 100 percent be focused on outputs and outcomes. Right now, the accreditation system is not focused on that, and it's really limiting I think, the innovation that we could see in higher education.

Mr. KELLER. Thank you. I was also interested to see that the chart you included in your written testimony which shows which fields have been most successful broken down by academic field,

can you speak to the metrics for coming up with the data reflected in the chart, and if there are any notable trends you found?

Mr. GILLEN. Yes absolutely. So, in the written testimony there's a chart in there that we look at. I think it's the 27 largest academic fields, and so this is using the 2019 college score accreditation. And so, what we did was we recreated the gainful employment regulations.

So, at that point the gainful employment regulations had been set aside. And so, what we did was we recreated them, but we applied them to everybody, not just for-profits. And so, when you do that, you can then classify each program as passing, probation or fail. Technically the probation was a public zone in the gainful employment regulations.

The probation is the essence of it. And so, when you do that, you saw some fields that you know virtually every program was passing gainful employment, and so fields like mechanical engineering, vehicle repair and maintenance, I think was above 90 percent of graduates were attending these programs that had these excellent outcomes.

But then there were a bunch of fields that weren't doing so well, so social work is now around a third of graduates were attending programs that would not have passed gainful employment if it had been applied to them.

And then the field that really stuck out as having the worst outcomes was actually law. And so, we did a followup report where we—

Mr. SABLAN. I'm sorry, but we need to get on to the next member. Thank you very much sir for your—

Mr. KELLER. Thank you.

Mr. SABLAN. Let's stay in Pennsylvania. Ms. Wild you have 5 minutes please.

Ms. WILD. Thank you so much Mr. Chairman. I'd like to direct my first question to Ms. Cao. I hope I got that correct and thank you all for being here on this very important subject. Ms. Cao whenever I am engaging in conversations about higher education, I want students to be central to the discussion.

And just by way of background, I want you to know that in my district, which is the Lehigh Valley, I actually have six colleges and universities that are non-profits as well as a couple of for-profit schools, so this is an area of great, great interest to me.

I believe it's vital that students who are pursuing higher education are able to do so with the peace of mind that the college they attend has their best interests in mind and will invest its resources to provide the highest quality education and the best outcome. I think we all feel that way about it.

So, what I'd like to do with that as a backdrop, I'd like to discuss the effects on students when for-profit colleges convert to non-profit colleges. When that happens is the college required to improve the quality of its academics or better support student's learning?

And all as the second part of my question at the same time. After undergoing a conversion, does the college have to improve the outcomes of students, like increasing job placement rates after graduation, or lowering default rates on student loans? And I'll be quiet now and let you answer. Thank you.

Ms. CAO. Sure, thank you. So, in order to be recognized by the Department of Education as a non-profit, a college does not have to improve the quality of the learning within the school or improve the quality of the outcome that the students experience.

However, to kind of return to the core distinction between non-profit and for-profit status, genuine non-profits make that commitment to reinvest 100 percent of resources in student learning. And to go to Professor Galle's point about fiduciary status, genuine non-profits owe a fiduciary responsibility for the educational mission of their school, and no fiduciary responsibility to investors or shareholders.

And what that means is that with all of those Title IV resources, going to support student education, you end up with better outcomes, and you end up with better investment in student's education. I want to go back to provide a clarification on the numbers regarding instructional spending that Ranking Member Foxx referenced earlier on, because this is something that I described in my written testimony.

So, when you look at the share of student's tuition dollars, the share of HEA dollars that is going to instruction, the numbers are pretty clear about what the difference is between sectors are. So, to take 4-year schools at a for-profit school students are getting 26 cents on the dollar.

At a non-profit they're getting on average 79 cents. And at a public institution they're actually getting more than a dollar's worth of instructional spending, \$1.13. So that's the best bang for your buck.

And the reason this is different from the numbers that Ranking Member Foxx was describing, is because she's incorporating at the denominator all of the revenue which includes revenue for Hadron collector generators for the research farm, or the revenue produced by the non-profit hospital that is attached to the institution.

So, when you're really looking at what students are getting, and I'm so glad you understood the conversation, it's a really different deal at for-profit institutions versus non-profit and public counterparts.

Ms. WILD. Can I just ask you in the time that I have left, are there particular types of students that are more likely to attend a college that recently converted to non-profit?

Ms. CAO. Yes. So, the for-profit schools who are engaging in these conversions are among the most predatory. We know that the target low-income students, Black and Hispanic students, working parents and students who don't have family support, but are rather supporting their families.

And returning to the case of the Ashford conversion to University of Arizona's global campus, you have the leadership there expressly saying, "We are pursuing this conversion in order to better target low-income students and minority students."

Ms. WILD. How does the quality of their academic instruction while they're in college and their outcomes after compare for students who attended a recently converted non-profit college from students that attended a non-profit that never operated as a for-profit?

Ms. CAO. The problematic conversions behave just like for-profit schools with the difference of a for-profit schools have to live by the

Gainful Employment and 90/10 rules. So, the outcomes are going to be significantly worse at converted schools that are genuine non-profits.

Ms. WILD. Thank you so much. I appreciate it. I yield back.

Mr. SABLAN. All right. Thank you very much Ms. Wild. I am told that Ms. Miller-Meeks is next. Ms. Miller-Meeks? All right we're going to try Mr. Owens? Mr. Good? Mrs. McClain.

Mr. GOOD. Bob Good's here.

Mr. SABLAN. Oh, Mr. Good. All right sir welcome, you have 5 minutes sir thank you.

Mr. GOOD. Thank you very much and thank you to all of our guests here today. And my questions will be directed to Dr. Gillen please. In your testimony you discussed how making available important data related to post-graduation outcomes for specific colleges and specific degrees can help students and families make good investments in their higher education, and that this trend could lower the overall cost of education.

That said, do you have a recommendation regarding how Congress can help promote and facilitate this data transparency without also expanding the size and scope of government?

Mr. GILLEN. Yes absolutely. So, the way the current college score card data is collected is it's focused just on students who are receiving Federal financial aid. And so, I think that's a completely appropriate approach because these Pell grants and students' loans are being provided to these students, just as kind of congressional and governmental due diligence, we need to be able to assess the overall outcomes of those programs, and so we need to be able to track the outcomes for students who receive these.

So, I think that's a very appropriate approach, kind of figuring out what information we need to determine how effective financial aid programs are and then collecting it.

Mr. GOOD. Thank you. You also had noted, and I'm paraphrasing a little bit, that you know since colleges are locked in a never-ending academic arms race, to spend as much as possible in the pursuit of prestige, and this has a very negative consequences regarding college affordability, and it can make it easy for insiders to hide excessive spending.

Do you feel that accountability regarding degrees and the labor market outcomes is enough to lower the costs of higher ed, or what else might you recommend?

Mr. GILLEN. Yes, so this is in reference to the Bowen's laws portion of my written testimony, and just very brief background. So, with Bowen's laws the basic is that when you can observe quality, you're competing based on reputation or perceived quality.

Mr. GOOD. Right.

Mr. GILLEN. And one of the ways you can increase reputation or prestige, or perceived quality is to spend more money on kind of flashy items. So, you know Nobel Prize winning faculty, high-achieving students you know big shiny new ads, that kind of stuff.

And so, you know that's all great, but that all costs money, and so schools are locked in this never-ending cycle of needing more revenue. And so as soon as they get more revenue, they use it to increase spending, and so if you look at the kind of overall trend

of what happens to higher education in this Bowen's Law world, is we're going to see a never-ending trend of increases in spending.

So, one of the ways we can escape that is by having better metrics on outcomes and outputs. And so, these accountability mechanisms that basically publicize, and try to encourage schools to have better outputs and outcomes would do a lot to fix that because right now there's a handful of law schools in the country that do a great job in terms of labor market outcomes relative to student debt.

There's also a ton of them that don't, where their students are really struggling with their student debt. And so right now the question hey, should I go to law school doesn't make any sense because it really depends on which law school we're talking about. Some of them have great outcomes, some of them don't.

And so, in providing students with enough information that they can make that distinction between those two types of programs is absolutely critical. And then once students are competing—sorry, once universities are competing based on the outcomes, we've basically escaped the Bowen's Law world and then we move into more of kind of a standard competitive environment where schools are competing to increase quality and lower cost.

And that's a very healthy environment to be in because any innovation that does either one of those will be adopted widespread by universities across the country.

Mr. GOOD. At the risk of offending my many friends who are lawyers here in Congress, it was interesting to see that one of the worst returns in your data provided was that for the law degrees, in light of we've got such a growth in that area in the country.

Just speaking though generally with regard to the cost of higher education, what role do you think that the overall Federal spending on education might be impacting the overall increasing costs of higher education?

Mr. GILLEN. So, there's a big debate among scholars about the extent to which Bowen's hypothesis is—I'm sorry the Bennett hypothesis is indicative. And so, essentially there's an argument that some scholars make that increases in government funds will encourage schools to raise tuition to essentially harvest those funds without actually lowering the cost to the students.

Now there's been you know multi-decade debate about how big of a problem this is, and so unfortunately, we can't go into too much detail. But right now, if I see a study that says it's less than 20 cents on the dollar, or a study that says it's more than 80 cents on the dollar, I'm skeptical.

Anything in between there is pretty consistent with the evidence that I've seen, so it's not that schools raise tuition by a dollar for every dollar that the government provides, and it's not that they don't raise it at all. It's somewhere in the middle.

Mr. GOOD. Thank you, sir. I see my time has expired. I appreciate your answers.

Mr. SABLON. Yes, Chairman Scott is back in the room and so Mr. Chairman you have the gavel please.

Chairman SCOTT. Thank you. Can you—is Mr. Levin next?

Mr. SABLAN. No. I think it's Ms. McBath, well she was here, all right. Mr. Chairman McBath, Ms. Hayes was here, yes, you're right Mr. Levin is he here?

Mr. LEVIN. I am.

Chairman SCOTT. The Gentleman from Michigan Mr. Levin.

Mr. SABLAN. Mr. Levin you have 10 minutes.

Mr. LEVIN. Ooh.

Mr. SABLAN. 5 minutes, 5 sorry.

Mr. LEVIN. I'll take the first offer. Thanks to you both. All right. Well, this is I thank the chairman for this hearing. It's super educational I think for the American people. Over the last decade for-profit institutions have converted to non-profit institutions at an accelerated rate, and we've seen an alarming amount of these conversions happening at ethically dubious for-profit colleges, converting to non-profit institutions to circumvent accountability, or repair their reputations, line the pockets of owners and executives, and evade tax liabilities to the American people.

Take for example Dream Center, a non-profit holding company that pushed for the purchase of three for-profit college chains with the intent to convert these schools to non-profit institutions even as the Higher Learning Commission revoked accreditation for some Dream Center owned schools over concern that the intent of the conversion was to and I'm quoting, "Cloak predatory practices."

This led Dream Center to misrepresent and defraud millions of students into believing they were attending a fully accredited institution when they were not. Within 18 months of the transaction Dream Center closed or sold every school.

So, I want to ask Ms. Cao about this. We've seen a lot of these abrupt and expensive closures of schools that are converted from for-profit to non-profit. For instance, the committee found that the Dream Center conversion and subsequent collapse, will cost taxpayers at least 600 million dollars.

Is there something particular about these conversions that makes them likely to close abruptly like this?

Ms. CAO. Yes. Thank you so much for that question. And the Department of Education did find that the collapse cost taxpayers 600 million dollars.

Mr. LEVIN. It's incredible.

Ms. CAO. One of the executives at Dream Center, who was extracting revenues for his family's foundation, actually estimated the overall cost of the closure would be 1 billion dollars, and that's part of the committee's report as well. But I think of the increased risk of closure that the GAO found in highlighting that 15 of 16 insider driven conversions went from being financially responsible, to financially irresponsible within the span of 1 year, is one of the real risks to both students and taxpayers of allowing these for-profit conversions to go forward.

I talked about how non-profits can never extract revenue for owners, and how for-profits have a restriction where when they are already financially unstable, owners cannot extract revenue for private benefit, or at least there are some restrictions in their ability to continue to withdraw equity.

But when you have a for-profit college that continues revenue extraction, but as a non-profit, they are free to extract dollar after

dollar to the point where they are running their institution into bankruptcy.

And in the case of Argosy, you saw owners extracting revenue to the point where the institution had used up all the Title IV funds, and then go after student's stipends in order to be able to balance their budgets. And then run out of all funds entirely.

And so, I think there is a real—

Mr. LEVIN. And milk it until it doesn't exist anymore basically. I mean since time is limited, let me just ask you to kind of zoom out because I mean in a way these stories about the particular institutions are so compelling and disgusting you know.

What I want to ask you is how can we understand the impact of these particular stories, these conversions and these subsequent closures on higher education and students as a whole? How are the for-profit conversions impacting other schools in both the for-profit and non-profit sectors, and how does that you know, end up impacting college students all across the country?

Ms. CAO. Thanks. So, when for-profit conversions happen among the most predatory schools, that impacts the rest of the for-profit field because any school that wants to remain with for-profit regulations when it has this option of a giant loophole, is going to be either too small, too unsophisticated, or too scrupulous to lawyer up and take advantage of the for-profit conversions that allow them to operate in an even more predatory manner.

When it comes to the non-profit status, there is also I think a corrupting impact of for-profit conversions on non-profits. And so, Mr. Gillen mentioned an arms race, and I think that the aggressive and predatory recruitment of for-profit conversions is going to, and already has created an arms race for the non-profits to try to distinguish themselves from the covert non-profits, and that's going to draw resources away from student instruction in order to be able to educate students through recruitment and marketing practices.

Mr. LEVIN. All right well thanks. Mr. Chairman my time's expired, but I just have to say that when I ran the State workforce system in Michigan and created the No Worker Left Behind Program when we put 162,000 Michiganders back to school, we proudly worked with State institutions, community colleges, non-profits and for-profits, and we've got to fix this problem so that students can still have the full panoply of options. With that I yield back.

Chairman SCOTT. Thank you. Next the Gentlelady from Iowa Ms. Miller-Meeks.

Ms. Miller-Meeks. Thank you so much Chairman Scott. And Ms. Cao you actually inspired this question. You said, "Higher tuition equals higher debt." As the first person in my family of 10 to not only go to college, the only one to ever go to medical school, I am extremely concerned about the rising cost of tuition.

At the State level, as a State Senator I worked on these issues, especially for the health professions. However, student loans, loan forgiveness for locating to rural areas, J-1 Visas, and scholarships don't address my most pressing concern, and that's the skyrocketing cost of colleges.

Mr. Gillen you've done a lot of work investigating why college prices are rising, and one reason you mentioned earlier was the Bennett Hypothesis. Could you describe this a little bit more in de-

tail, and also other drivers of rising tuition and suggest ways Congress could address the fundamental drivers of college cost when we reform the HGA because that in turn is what creates more college debt is the rising costs. Thank you.

Mr. GILLEN. Yes absolutely. So, one of the main contributors to rising college costs is this Bowen's Law world that I described previously where there's essentially never-ending need for any non-profit, but in this particular case, colleges to have more revenue.

There's always going to be some other program, or some more students, or some initiative that the University wants to take and that they think will improve their college. So, there's never going to be enough money for colleges.

There's a couple of amusing kind of descriptions of this process by scholars of higher education. So, Derek Bach, former President of Harvard, he wrote a book where he described colleges as just like compulsive gamblers in the sense that there's never going to be enough money to their needs.

There's a scholar at Cornell, Ronald Ehrenberg who described the college's need for money as analogous to the cookie monster, just whatever cookies are available, cookies being revenue in this case will be devoured.

A co-author of mine, Robert Martin, described higher education finance as a black hole, and it will just suck up any revenue that's around. And so, the question is OK, what happens when we institute a financial aid program in this environment? And that's where the Bennett Hypothesis comes in.

And so, Secretary Bennett, he was Secretary of Education back in the 80's. He said that the Federal Government providing financial aid will actually encourage these schools to raise their tuition—to harvest that aid money. And that's really the combination of these two. So, the Bennett Hypothesis is a danger because we live in this Bowen's Law world.

And so, the question is OK well how big of a problem is it? And scholars, as I've mentioned, have been debating this. There was a real turning point around 2012 where almost all the scholarship that has come out since then, because it's using better data, and better school techniques, is finding some evidence in support of the Bennett Hypothesis, regardless of sector.

So, it's you know an issue at the for-profit sector. It's an issue at public's, it's an issue at private non-profits. And but there are some things that could be done to sort of attain the Bennett Hypothesis. And so, some of the things you can do is make sure that it is need based.

So, programs like the Pell grant are much less likely to suffer from kind of tuition inflation as a result of the program, than kind of a universally available program that is not subject.

Ms. Miller-Meeks. Thank you so much for that, and it's the same thing that plagues our healthcare with third party payment, and I'm going to yield the balance of my time to Representative Foxx. Thank you so much. And thank all the panelists.

Ms. FOXX. Thank you very much for yielding. I want to point out that one of our witnesses has said non-profits can never extract revenues for individual benefit. Well, I'd like to point out that private colleges and universities, some are paying exorbitant fees to

their presidents. University of Southern California, 7 million dollars. University of Chicago, 6 million dollars. Thomas Jefferson University, 5 and a half, Columbia, 4 and a half million. Harvard, 3 and a half million. University of Pennsylvania, 3 million.

Wesleyan University, 3 million. University of Rochester, 3 million. Texas Christian, 2 and a half and the Savannah College of Arts and Design, almost 2 and a half million. I would say that students going to those schools would say that that is extracting revenue for individual benefit.

And then Mr. Chairman, we'll enter that into the record. This has come I believe from it's a Chronicle of Higher Education, and also the top 10 salaries of public schools. Georgia State, 3 million, Auburn, almost 2 million, Texas A and M over 1 and a half, Ohio State, 1 and a half. Texas A and M, system office 1.3. University of Pittsburgh, 1.2. University of Virginia 1.2.

University of Nebraska a little over one million. University of Houston 1 million, a little over, and Arizona State University incidentally, over 1 million. I would say those publics and those privates are certain extracting revenue for personal gain.

And I think the record needs to be straightened out. Thank you very much Mr. Chairman.

Chairman SCOTT. Thank you. Those documents will be entered into the record without objection. The Gentleman from Indiana, Mr. Mrvan.

Mr. MRVAN. Ms. Cao you have written about Perdue University's joint venture with Kaplan University. Based on your knowledge of this conversion, do you see any unique risks posed by public college contracts with for-profit colleges compared to a for-profit college's conversion to non-profit status?

Ms. CAO. Could you repeat the second half of your question, I'm sorry I didn't hear it.

Mr. MRVAN. That's OK. The second half of it is do you see any unique risks posed by public college contracts with for-profit colleges compared to a for-profit college's conversion to non-profit status.

Ms. CAO. Got it. Thank you for clarifying. Yes, so I think of the risks of for-profit colleges converting in a way where they appear to have public college status, or a public college affiliation is even more pronounced because of the public trust that students have in a school like Purdue University, or the University of Arizona.

That is why shareholders at Graham Holdings or the shareholders at Zovio are so excited when they can find a public institution that will lend its good name to one of these for-profit college conversions.

And I think the students have really spoken for themselves. Purdue University Global is the only public college that has garnered more than 100 student complaints through the borrower defense program. And I also want to add that there are two additional risks with these for-profit public conversions occur.

One is the double revenue extraction. So, you have funds from student tuition dollars going to both Graham Holding and to support Purdue. And the third harm is that equity harm that I mentioned at the beginning.

You have separate unequal institutions where poor students are subsidizing wealthier students.

Mr. MRVAN. Well, thank you very much and I yield back my time.

Chairman SCOTT. Let's see. Good, McClain, the Gentledady from Tennessee Ms. Harshbarger.

Ms. HARSHBARGER. Thank you, Mr. Chairman. I appreciate the time. This is directed to Dr. Gillen. I have constituents in East Tennessee that a traditional 4-year degree is really it's not the most practical steps for those high school students, and really for a lot of the adults looking for a post-secondary degree. And I absolutely agree that we need to have accountability measures put in place for any institution, like the learning versus earning, versus growth.

And there's no way to measure out if we don't have those measures. And Dr. Gillen for-profit colleges don't just take public money and in the form of those Title IV student aids programs, but because they do pay taxes to State and Federal Governments, really, they're taxpaying institutions basically. In addition to paying taxes, these schools employ thousands of people. They contribute a lot of other ways to a local economy or community.

And my question is this. Are you aware of any analysis that's done to assess the real value-added institutions have on their communities? What is it that they do to these communities? How do they give back? And have you assessed anything that would show us what these measures do and those employees, in hiring all those employees, what kinds of value does that have on the community?

Mr. GILLEN. Yes, sorry about that. So, the first part of the question you know what is the overall social impact of—these higher education, and does it distinguish between for-profit, non-profit and public. And so, whenever you have either a subsidy or a tax, that's going to introduce a wedge between the social return to any particular activity and the private return.

And so, when you look at higher education if you compare say the public university to a for-profit university. So, the public universities are generally heavily subsidized by the State that the reside in, and they do not pay taxes.

And so, you've got sort of two wedges that are kind of present for public universities. The for-profit universities, not only do they not get subsidized, but they do pay taxes. And so that's going to introduce a big wedge between the social rate of return relative to the private rate of return.

So, if you just for simplicity just assume the equivalent private rate of return for students at those, you can see very, very different social rates of return because of the subsidization and the different tax laws.

As for what higher education does for the communities, it really depends on the particular community, and on the universities within it. And so, a lot of states actually import college graduates, and so a particular State may really generously fund its colleges to try and increase the educational attainment level at the population, and then it sees a lot of those students just move next door because they want to live in New York City or something like that.

And so, it's an open question how much at the local community level the universities are going to benefit, because it really depends on how many of those students remain within the community, and how many go to some other community.

At the national level that's not as much of an issue. You still have students going internationally after they graduate, moving overseas. But at the community level that's much broader.

Ms. HARSHBARGER. You know our goal should be to get, it doesn't matter which university if it's public, for-profit, not for-profit, you know the goal is to get these students educated, or to give these adults post-secondary degree.

As Dr. Miller-Meeks said, I was the first one in my family to ever go to college and get a Doctorate degree in pharmacy. And nobody encouraged me, that's just something that I wanted to do along the way. And I went to a private institution, and it cost a lot of money. And I paid every penny of that back. You know we look at these endowments at some of these bigger not-for-profit universities.

They could bankroll every student that came through their doors if they wanted to. So, I guess just having those measures in place to see how successful these for-profit, not for-profit universities are, it's how you do it in the business world.

You've got to make sure. And my part of the State, in East Tennessee we need skills training. We need things to where they can get out and get a good job. And I'm now knocking higher education, but I'm looking for you know, my emphasis is on workforce development per se in my district.

But I appreciate your answers. I think that we need to look and assess what these for-profit universities do and do some kind of a study to show what they do to imply. They employ all these people in their communities. Let's find out what kind of benefit that has been and measure it that way as an outcome.

But I appreciate your answers, and everybody being here, and I yield the remainder of my time to Dr. Foxx.

Chairman SCOTT. Actually, there's not any time left.

Ms. HARSHBARGER. Well, I'm so sorry.

Chairman SCOTT. The Gentlelady's time has expired. Next the Gentleman from New York Mr. Jones.

Mr. JONES. Well, thank you Mr. Chairman and to the Ranking Member. Thank you to our witnesses for all appearing before us today. Your testimony has placed a spotlight on the failings of the Federal Government to adequately protect our students. Make no mistake about that.

Over the last 30 years for-profit colleges have offered minimal educational value, but have collected millions of dollars in tax breaks, all while saddling thousands of students with crushing debt. In recent years as skepticism of for-profit schools has continued to grow, these same predatory institutions have taken it upon themselves to restructure and convert to non-profits.

They have done so not because they have seen the error of their ways, but because they seek to subvert the regulatory burdens placed on for-profit colleges, while continuing to defraud students and benefit financially.

Ms. Cao how do for-profit colleges in disguise, or as you refer to them covert non-profits harm students?

Ms. CAO. Thank you for your question. And first I just want to take a point of personal pride to say that we overlapped at Stanford University, and you graduated with many of my friends from Harvard Law School and I was so excited to see you elected.

And I'm excited as well for your focus on the harm that students experience as a result of the activities of covert for-profit schools. And to return to the student harm, again I think the students have really spoken for themselves.

When you look at the borrower defense claims that students submit, when they feel that they've been defrauded by institutions of higher learner, when they feel that their tuition dollars and debt dollars have been taken from them by deceptive and abusive practices you see crystal clear that it is for-profit and covert for-profit schools that are deceiving students.

You can look at over 300,000 borrower defense claims the Department of Education has identified by institution, about 25 percent are from covert for-profit colleges, about 75 percent are from for-profit colleges. Less than 1 percent come from the non-profit sector, and there are no public institutions on that list except for the affiliation of Purdue University Global.

So, I think that it's really clear that the student harm is coming from the for-profit and covert for-profit sector, and if we don't do something about it, those types of harms are going to expand to corrupt the influences that are in place even further.

Mr. JONES. Thank you for that. And what are the risks covert non-profits pose to taxpayers in particular?

Ms. CAO. Yes. So, when it comes to stewardship of taxpayer money, there is a particular risk when covert for-profit owners can draw down revenue with one hand and then pass it on to insiders for personal enrichment on the other hand.

Representative Foxx talked about the salaries of non-profit presidents. But you have the president of Harvard making 3 million dollars a year, and the president of Keiser University, one of these covert for-profits, drawing down 34 million dollars a year through rents and loans paid by the non-profit that he owns. And I think that is a huge problem for taxpayers, especially if Congress takes a look now to double down on the investment and low-income students for things like Pell grants.

You have to protect that investment from being handed right into the pockets of insiders with little benefit for students.

Mr. JONES. I so appreciate that illuminating testimony. And with the approximate minute and 20 seconds I have left, I wanted to delve into the demographics of the impacted students. We've touched a little bit on how these for-profit colleges in disguise arm students.

But we know that certain communities really bear the brunt of the adverse impacts, and so can you talk a little bit about who these students are in terms of the demographics, and you know what's the profile of these students who enrolled in these covert non-profit colleges?

Ms. CAO. It is low-income students, Black and Hispanic students, working students, working mothers in particular, and students who are supporting their families instead of being supported by their families.

In the world of research, we talk about reverse redlining or predatory inclusion, and I have a background representing low-income borrowers in the sub-prime mortgage crisis. There you talk about how banks have excluded minority borrowers, and what that leaves space for is predatory institutions to come in and offer a sub-prime product, saying that they're providing access, when in fact they are extracting wealth from those communities that need it most.

And that's what we had in higher education as well. We have predatory inclusion so that individuals who have been pushed out of valuable resources in the higher education field are being steered toward predatory actors.

Mr. JONES. Thank you so much Ms. Cao. Go Stanford and I yield back Mr. Chairman.

Chairman SCOTT. Thank you. The Gentleman from North Carolina Dr. Murphy.

Mr. MURPHY. Thank you, Mr. Chairman. And I want to say thank you to all of the Members who have come to the committee. I appreciate your perspective. I want to say specifically Mr. Galle you made one point that you thought that it was education's duty here, not the IRS to police these institutions, and I think that's correct.

I think a lot of the comments here may have been misguided a little bit, and they obviously have a different reason for saying this. I do want to point out one thing though. I mean it's very interesting that we're just attacking the private institutions—I mean the profit not for-profit status.

And if you look at our—I don't know if any of the other panelists have actually been on a college campus recently and looked at where money is actually spent on college campuses. Yes, there surely are aberrations and abuses in salaries, but if you look at what the taxpayers are paying for, and you look at what's happened with administrative bloat, I would submit that that is infinitely more of a problem to the American taxpayer, to the American student, than any of these problems that are heretofore this committee has brought up.

This is the main reason that students are in debt these days is because administrative bloat has far outweighed payments on anything academic-wise, and to say otherwise is really just ignoring the issue and just attacking the for-profit institutions. So that said, Dr. Gillen let me just ask one brief question, because I'm going to cede a lot of my time to Dr. Foxx who's smarter than I am on these things.

The premise behind this hearing seems to be that for-profit conversions are a big, huge public policy issue. They're happening often, and they're not being handled appropriately, and that legislation is needed to fix this problem. Is that premise correct?

Is it true, or are we dealing with such a huge, massive problem that several of the committee people have said, of the more than 5,000 institutions of higher education, how many of these are actually impacted by conversions?

Dr. Gillen I'll let you answer those questions please.

Mr. GILLEN. So very few former formerly for-profits seek to undergo conversion, and even fewer of those involve insiders. So, this is a relatively small problem. And to the extent it's a problem, it's

already forbidden, so the IRS doesn't allow an improper benefit and the Department of Education doesn't allow an improper benefit. So, the real question is does this—do the existing procedures used by IRS detect improper benefit?

And so, if not, then that's an argument to improve those procedures. But the idea that all for-profits who undergo conversion are bad, I don't think is valid. And it's not even really internally consistent right, because we've been hearing about oh for-profit's bad, non-profit's good.

Well, we're converting for-profits into non-profits, but they're still not good. So, it's kind of a strange approach.

Mr. MURPHY. Well, I thank you because it's you know without a doubt obviously our job as Members of Congress are to hold institutions accountable, but this is a chasing, in my opinion like we say in medicine, a wild herring. It's not really, it's more of a problem in search of a solution, and or rather a solution in search of a problem.

I'm sorry for the mix-up. But I mean if you really look back, and I'll get on my rant of administrative bloat, and if we're actually caring about what's going on for students, that's the whole premise of this, if we're caring about what's going on for students, then look and see what colleges, public colleges, universities, private colleges and universities, how they are spending their money these days.

And it may not be on massive salaries, but it is on administrative bloat, and that's been the death knell of higher education these days. With that I'll yield back the balance of my time to Dr. Foxx thank you.

Ms. FOXX. I thank the Gentleman for yielding. And I would like to—

Mr. GILLEN. You got muted there Representative Foxx.

Ms. FOXX. Oh, OK. Well, the Federal student loan 3-year default rates by sector and separation cohort, borrowers, and repayment in 2009 to Fiscal Year 202017 by the college board it shows public 2-year schools have a 14.4 percent default rate.

The for-profit schools have a 12 percent default rate. And so, we see that 2-year colleges have a worse default rate. And I would like to ask a quick question of Ms. Emrey-Arras. From Dr. Adams, she asked you which conversions were better. And I want to know were you expressing a personal opinion, or one based on research in your official capacity?

Ms. EMREY-ARRAS. I'm not sure that I answered on that front. Can you remind me?

Ms. FOXX. Well, she asked you whether it was better for schools to go to for-profits, but I can get you the exact question and submit it to you for the record. But it sounded as though in your official capacity you are expressing an opinion, and I was just clarifying that.

Ms. EMREY-ARRAS. I don't recall that, but I'm happy to answer any questions that you may have for the record.

Ms. FOXX. OK thank you.

Ms. EMREY-ARRAS. Sure.

Ms. FOXX. I yield back.

Chairman SCOTT. Thank you. The Gentlelady from North Carolina Ms. Manning?

Ms. MANNING. Thank you, Mr. Chairman. I'm going to address my first question to Ms. Cao, and I don't believe this is something that any of my colleagues from North Carolina have raised, but it's of great interest to constituents in my State.

Reporters are raising questions about a non-profit that is a covert for-profit that's taking place in my State, and you're nodding your head. You probably already know about this. The Century Foundation reported on documents obtained from IRS and the Department of Education showing that Dr. Arthur Keiser who I believe has been discussed today, converted his for-profit college into the non-profit Keiser University to use it as a cash cow.

And new reports indicate that Dr. Keiser has funneled donations from Keiser University to a traditional financially struggling, non-profit, St. Andrews University in North Carolina to assert control of that institution, and potentially leverage that control to benefit Southeastern College, a for-profit school which Dr. Keiser owns.

We are extremely concerned about this. Of course, I'll be following up with Andrews University for more information, but I am getting calls from very concerned constituents. Can you expand on these findings, and do they raise wider concerns both for St. Andrews, but also for other conversions?

Ms. CAO. Thank you. Yes. And so, we have taken a look at St. Andrews and the relationship with Keiser University. You know you've heard of corporate takeovers within the private industry. Here we have a hostile takeover of a non-profit school that was experiencing financial strain.

And coming out of this pandemic, and of economic hardship, we're going to have a lot of small, community-serving non-profits that are experiencing financial strain.

So, I think watching the pattern of this instance, and watching the patterns with these for-profit college conversions more broadly, is not responding to a hypothetical question, but it is responding to the early signs of a trend that is about to become much more dangerous and could be more widespread if action isn't taken now to reverse the trend.

Getting back to the example of St. Andrews, we have a pattern that we've seen before where the Keiser family has leveraged the wealth that it obtained by extracting resources from other for-profit college conversions and used that wealth to buy control of the board of St. Andrews.

With that control the Keiser family is operating St. Andrews in a way where it's starting to operate similar to a vassal State, which is to say it is not operating in the best interest of students, but rather helping to extract resources and deliver them to the for-profit school that is currently held by the Keiser family, Southeastern.

And what we've seen is this example where they've opened up a new campus, called the new campus an extension of St. Andrews, but it's actually listed at the same address as one of the campuses for the for-profit school that the Keiser family also operates.

I think it is possible that we'll see an application for a conversion in the near future, but even if not this relationship of a non-profit being taken over and its good name used to support insiders is a perfect example of the concerns this hearing addresses.

Ms. MANNING. Thank you so much. We have several non-profits, small non-profits in my community that as a result of this pandemic are really struggling. I would hate to see this happen to any of our other good schools, so I'm going to switch the next question to Administrator Emrey-Arras. If you could help me understand what are the tools of the Department of Education, the IRS, and Congress can use to make sure this doesn't happen?

Ms. EMREY-ARRAS. Thank you for the question. So, the IRS can review proposed conversions when new non-profits are applying for tax-exempt status. So, they can actually ask for the purchase price of a college. They can look at independent appraisals, versus getting a promise that a price will be fair market value.

So, they could actually request materials to help make that decision, and if they decide that a sale is not going to be a fair market value one, they can deny the application for tax-exempt status. After that, they have the ability to monitor tax-exempt organizations at a future date and our recommendation will help them do that more.

On the education side, you know the department has done a lot in recent years to step up its oversight for those initial applications right? It's looking at more documents. It's looking at key bids, it's looking at contracts, it's really getting into the nitty-gritty to figure out is there improper benefit going on. So that's a good thing.

But at this point it's not looking at what happens after it grants its approval, so those schools are in provisional status for one to 3 years, they're supposed to be closely monitored. Education already has their financial statements. It's using them for other stuff, but it's not actually looking at them to see if any improper benefit is happening at that point, and we think it should.

Because you can find information in the statements about ongoing leases and other kinds of vendor arrangements that could raise questions about improper payment. So, we made a recommendation that the department use the information it already has to do a better job of monitoring, and the department agreed with us.

Ms. MANNING. Thank you and I yield back.

Chairman SCOTT. Thank you. Gentleman from North Carolina, Mr. Cawthorn.

Mr. CAWTHORN. Thank you, Mr. Chairman. I sincerely appreciate all of the witnesses to have come on to be able to testify before us. I am disappointed that we are using our time with all the brilliant minds on this committee to be working on examining colleges converting from for-profit to non-profit status which impacts roughly 0.1 percent of for-profit colleges, and just in layman's terms that is 3 colleges a single year.

I feel like the brilliant minds that are at use here and on this committee as our witnesses could be used for something more tangible, but I will take some time to ask you a question Dr. Gillen. The Higher Education Act makes all institutions, regardless of their tax status, ineligible to operate with Title IV student aid programs if too many of its students default on their loans within 3 years of leaving the college.

Could you comment on whether this cohort default rate metric is effective, or also how can we as Congress, how can we improve upon it?

Mr. GILLEN. Yes. So, the cohort default rate is I think a perfectly fine accountability metric. The problem is that it's used as the accountability. And so, this is really the only way that schools can lose Federal financial aid for any sort of outcome that they have.

And so, the cohort default rate could certainly be improved, so right now it looks at just the first 3 years after the loans, and so I think we could benefit from extending that. So, whether we want to look at you know 5, 10 or all of the above, maybe we have 3 different cohort default rates that we examine.

I think that would be real useful. Another potential issue, particular for the 3-year rate is that a lot of students can be in deferment or forbearance which won't show up as defaults on our loans. But these are so indicative of the students who are struggling with their student loans.

So, I think to really addressing kind of those flaws within—not flaws, but improvements in the cohort default rate. In terms of kind of the longevity of the cohort default rate, as more and more students are entering income driven repayment programs, that's actually going to turn the cohort default rate into an obsolete metric, because now students who can't afford their loans are defaulting on them.

But once they're in an income driven or payment program, they're no longer defaulting on their loans, their student loan payment has just been set to zero. And so pretty soon as more and more students are entering the income driven or payment programs, the cohort default rate is really going to be an obsolete metric.

So, one thing that we could do is replace it or supplement it with a repayment rate, and so that would be probably the wisest course of action I think where we look at what percentage of a university programs students are actually paying down the principal on their loans.

Mr. CAWTHORN. Well Dr. Gillen thank you very much for your time, and to all the witnesses thank you and with that Chairman Scott, Mr. Chairman I would yield the rest of my time to Ranking Member Foxx if she would so like to use it.

Ms. FOXX. I thank the Gentleman for yielding. Since we're on the gainful employment and cohort default rate, I want to point out that there's an article in the Chronicle of Higher Education that pointed out that there were failing programs in the theater arts program at Harvard University, a music performance program at Johns Hopkins, and a music technology program at the University of Southern California.

I think it's important that we point that out. Ms. Emrey-Arras. First to clarify, just because an insider was involved in the transaction does not mean that they are illegal when a for-profit converts to a not for profit, isn't that correct?

Ms. EMREY-ARRAS. That is correct.

Ms. FOXX. OK. So, when the GAO noted that the Department had strengthened its review of the process, that came about during the Trump administration is that correct?

Ms. EMREY-ARRAS. The department took several steps over time beginning in September 2016, though in 2018 the department did create a centralized team where they brought in experts with con-

tracting knowledge, and finance knowledge to really look at these together, and that was in 2018.

Mrs. FOXX. Right. So, they strengthened it during the Trump administration beginning in September 2016 as you said, right? Just before the election.

Ms. EMREY-ARRAS. Right.

Mrs. FOXX. So, I think it's important that we ascertain that when that strengthening came in was under a republican administration. Again, I think Republicans—the point we want to make over and over again, is that Republicans want accountability from all institutions, all institutions for students.

Thank you Mr. Chairman I yield back.

Chairman SCOTT. Thank you. The Gentlelady from Georgia, Ms. McBath.

Ms. MCBATH. Thank you, Mr. Chairman, I'm really excited to be here today and thank you to all of our witnesses for their great testimony. And I would just say in my own district we saw first-hand what happens when an institution of higher education attempts to evade accountability.

In 2019 Argosy University in my district closed its doors after months of misleading students on its accreditation status in an attempt to convert to non-profit status through its sale to Dream Center Holdings. In the end Argosy University ripped off thousands of students at campuses across the country, including one in my district, leaving them with untransferable credits, huge amounts of student debt, and degrees that just really aren't worth anything.

And it's our duty as legislators to protect the success of our students as they pursue higher education and hold all institutions accountable, and that's why I am very proud to be introducing the For-Profit College Conversion Accountability Act, or we'll call it the FCCAA with my colleague representatives, Sara Jacobs and Kathy Manning.

FCCAA would establish explicit criteria requiring the conversion to be made public, with proper advance notice and prohibit the institution from marketing itself as a nonprofit until the conversion has actually been given the final approval by the department.

Additionally, the bill would establish an office within the Department of Education to determine the eligibility of for-profit IHE's and monitor the conversion process. You know our students deserve better, and it's our duty as legislators to ensure that institutions are adhering to high standards.

Ms. CAO my questions are you for today. In a recent piece you wrote that and I'm quoting, "To increase rigor of the Department of Education's review, reviews of college conversions needs to continue in the Biden administration and should be applied to conversions that were approved earlier."

What opportunities are there for the department and this committee to revisit conversions that were previously approved?

Ms. CAO. Thank you for the question and for recognizing the painful experience of Argosy students. And so, I want to talk about three opportunities that the Biden Administration has to revisit some of the errors that were made in the past, and that we're played out in the GAO report.

The first is that in the case of the Dream Center the Department of Education made an effort to retroactively grant non-profit status to Argosy and the other Dream Center schools. And I would say the Department of Education can retroactively grant non-profit status in order to help institutions cheat students, then they sure should be able to retroactively remove non-profit status to stop that cheating.

And I think that that is an important authority to explore. Second, this has come up previously, but any time an institution of higher education seeks a conversion in a non-profit status, or a change in control, they go through a review that leaves them in a status known as provisional certification.

When you change status, you change control. Your eligibility to receive Title IV ends at that moment at the change of control, and you have to prove that you deserve Title IV funding all over again.

That gives the Department of Education a unique opportunity to continue to monitor and oversee whether these conversions are truly serving students.

And finally, I want to just go back. We've been talking about conversions between non-profit and for-profit status, but really there are a series of requirements that Congress has imposed that all institutions must meet in order to be eligible for Title IV revenues. And some of the behaviors in these conversions, things like paying recruiters or recruitment entities a bounty for each student that they enroll, would violate the basic requirements for Title IV eligibility for all institutions, and the department has to address that as well.

Ms. MCBATH. Well, thank you so much. And you previously wrote that our institution chain of for-profit schools had been sold to Dream Center Education Holding, a non-profit organization. It cooked the books and diverted stipends intended to cover student's groceries and living expenses.

And I'm aware that the Department of Education sat on the Art Institute's application, and that of Argosy International, Argosy University for non-profit status until it was too late. Do you have views about whether the Department's slow-moving response constituted a failure in oversight, and what do you think has been done differently, or could be done differently?

Ms. CAO. The department failed students by not acting to protect them. And they failed taxpayers by allowing millions to go out the door to an unscrupulous and irresponsible institution that did not meet basic statutory requirements to receive Title IV dollars.

Ms. MCBATH. OK. And thank you so much. I yield back the balance of my time.

Chairman SCOTT. Thank you. The Gentlelady from Illinois, Ms. Steel.

Ms. STEEL. Thank you, Chairman. I came from California, not Illinois.

Chairman SCOTT. I'm sorry.

Ms. STEEL. Thank you, thank you Chairman and thank you Ranking Member—

Chairman SCOTT. I'm sorry the Gentlelady from California Ms. Steel, I'm sorry.

Ms. STEEL. And thank you for all the witnesses today. I really appreciate it. I think we can all agree that we must protect the use of taxpayer funds. We also agree the cost of college has grown out of control. We need to make sure the students who attend any college will graduate, and graduate with the skills they need to get a job.

I believe we must have accountability, but also encourage flexibility to help all Americans find the higher education option that fits them the best. Colleges and universities have many reasons to choose whether they form as for-profit or non-profit organizations.

One of the reasons for conversion is the heavy, and sometimes unfair, burden places on for-profit institutions. Having said that, Dr. Gillen in your opinion if you run a for-profit college, wouldn't you want to change from a for-profit to non-profit to level the playing field since there are many burdens on for-profit colleges?

Mr. GILLEN. Yes. So, I think that's a completely valid point. There are a number of reasons that universities would want to convert from for-profit to non-profit. And so, some of them that were highlighted in the GAO report were there was a State financial aid program that provided grants to students. The students at for-profit colleges were not eligible for this grant.

And so, by converting to a non-profit that college's students would now be eligible for this financial aid program. And so, there's all sorts of issues like that where for-profits might benefit from converting into a non-profit.

Ms. STEEL. And testing's done too.

Mr. GILLEN. Yes, yes.

Ms. STEEL. For those schools. So, students across the board seem to be left with excessive student debt these days. Can you highlight some of the ways a successful for-profit college can help students who want and demand jobs?

Mr. GILLEN. Yes absolutely. So excessive student debt is a huge issue, and it's gotten a lot of national attention, appropriately so. The contribution I would like to see is the conversation less focused on the tax status of the degree granting institution, and more focused on the students themselves.

And so last year we actually ran an analysis that basically subjected all programs to gainful employment. So, under the initial gainful employment regulations no degree program at a public or a private non-profit was subject to gainful employment, so only certificate programs were.

And so, which is nonsensical right, like the MBA program at Wharton was not considered a vocational program, but a nursing program at the University of Phoenix was. It was just a bizarre way to define which programs are vocational and which aren't.

But so, we went back, and we analyzed, OK what if you applied gainful employment to everybody? And so, we used the new college scorecard data to do that.

What we found were that of the total students who are attending programs that would have failed gainful employment, 28 percent of them attended for-profit universities, which means that 72 percent of them were attending private non-profit or public universities.

And so, the notion that excessive student loan debt is a problem that's restricted to the for-profit sector, I think is completely false

because the vast majority of students who had excessive student loan debt, as determined by a test like gainful employment, are going to be at public and private non-profit universities, if for no other reason than for the fact that so many more students are at those institutions.

Ms. STEEL. Thank you very much Dr. Gillen. I yield my remaining time to Ranking Member Dr. Foxx.

Ms. FOXX. I thank you Ms. Steel. Mr. Gillen we've talked a great deal again about what we want to see and the bias that exists against for-profits. As we've talked about this you've talked about program accountability, and I'd like you to mention that a little bit more because I am very concerned about the possibility of our going to individual students, and if you wouldn't mind mention how much information we can get from program accountability.

Mr. GILLEN. Yes absolutely. So, the most exciting kind of accountability potential that I've seen in my entire career has been the college scorecard data on program level earnings.

So, they define the program as a university, a degree level, you know, associates, bachelor's, master's, and a field of studies. So, an academic field. And so, this is completely revolutionary to what we can do with accountability in higher education.

Because up until now we've only really applied accountability at the entire university. And so, we've looked at things like the cohort default rate, which are calculated at the entire university level. With this program level accountability, we can really analyze specific programs, and you mentioned earlier in the comment there was a program at Harvard, it was a certificate program, so it was actually subject to the—that actually failed.

Nobody knew. Nobody knew that this program was leaving its students with excessive student loan debt because nobody had bothered to look at the program level outcomes. And so, there's going to be a million examples like that. Where now that we have this program data, we can do a much better job of saying OK, you know the institution is doing great, but these four programs at this institution aren't.

Or you know, this university is really struggling, but these handful of programs are having really good outcomes for the students. And so, this program level of protecting is—

Ms. FOXX. I think Mr. Gillen my time is up. I need to stop you thank you.

Chairman SCOTT. Thank you. Next is the Gentlelady from Connecticut Ms. Hayes.

Ms. HAYES. Thank you, Mr. Chair, for holding this hearing today. When predatory for-profit schools don't follow the rules, the victims are often our most vulnerable students, first generation students, students of color, low-income students, working parents.

When for-profits shutter their doors, students are left with tremendous debt and no credentials. Last Congress I introduced a bill that would restore Pell grant eligibility to students deceived by Corinthian College and ITT Technical Institute. I'm so proud that that legislation was signed into law in December.

But we still have a long way to go. Ms. Cao my questions are for you, and I would ask you just I want to follow the rules to be mindful of the time on the clock. What role should transparency

and consumer awareness play in addressing the risk posed by for-profit college conversions, and should more information be given to students about those conversions?

Ms. CAO. Thanks. I would say transparency is necessary but not sufficient. And one aspect of transparency in the context of these conversions is making sure that institutions are not pulling the wool over students' eyes by claiming non-profit status when they're actually operating as for-profit institutions. I would also say that while choice is wonderful, and I support students having options of the type of college they go to, nobody wants students to be steered toward a choice that is going to harm them more than it will help them.

And you know, you can look at the grocery store. You can look at the auto dealership, all of these contexts where we have consumer choice, there is a regulator making sure that you don't buy spoiled milk. There is a regulatory making sure that you don't buy a car that's going to explode when you drive it off the lot.

Ms. HAYES. Thank you. That leads me to my next question for Director Emrey-Arras. Are colleges allowed to advertise as non-profit colleges while they're awaiting the Department of Education to approve their conversion applications?

And what did you find when you looked at the advertisements of colleges in pending status?

Ms. EMREY-ARRAS. That's a great question. When we started our study education didn't have any formal rules on this issue and during the course of our work, they did decide to formally prohibit this practice, and they have developed instructions to schools letting them know that this is not allowable, and they have begun to distribute those instructions.

And this is particularly important because we found that schools were doing that kind of advertising, so they were waiting for approval, did not have it yet, but yet were putting out in advertisements that they were non-profit institutions suggesting that they had been approved by the Department of Education to be non-profit colleges.

That was not true. We saw that for all nine schools that were pending, and we also looked retroactively at some of the schools that had been denied. So, the two schools that were denied, we found had also previously advertised as non-profits. So, we think it's great that the department has formally said that this is not acceptable, and we think it's really important that they're getting the word out.

Ms. HAYES. You've actually answered my next three questions. I'll wrap it up by saying you know what steps the U.S. Department of Education is taking to stop these deceptive advertisements.

Ms. EMREY-ARRAS. Yes. So, they're actually putting it in their letters to schools that are awaiting decisions. They haven't notified each and every school yet, but they are in the process of doing so, so they're going to organizing their communications to make sure that they consistently message along those lines, and we think that's great.

Because again, at the beginning of this study it was really quiet on this front, and a lot was going on that was against education's

wishes. Education officials have expressed concerns about this, but there is nothing formally prohibiting it.

Now the department has formally prohibited it and is telling schools that they're not allowed to do that.

Ms. HAYES. Thank you. I really appreciate that and for your expertise on this issue at today's hearing because as legislators we are tasked with making sure that we are protecting the rights of all of our constituents no matter how big or small the problem is, and it doesn't matter—one student affected is one too many, so I'm very happy that you've taken the time to come before this committee to share your concerns so that we can make sure that we are protecting every student that seeks a higher education in this country,.

With that Mr. Chair I yield back with 10 seconds to spare.

Chairman SCOTT. Well, thank you very much. And next the Gentleman from New York Mr. Bowman.

Mr. BOWMAN. Thank you, Mr. Chairman, and thank you to our witnesses for being here. My first question is to Director Emrey-Arras. You note in your testimony that the IRS did not systematically collect the information that can help identify insiders involved in conversion transactions.

When the IRS is evaluating an application for tax-exempt status involving insider transactions, what is it supposed to be looking for?

Ms. EMREY-ARRAS. It's supposed to be making sure that those transactions are a fair market value, so that no one is pocketing anything extra above what the price should be. So that's what they need to be doing, and they don't always have the information that they need to make that decision.

Mr. BOWMAN. How is fair market value determined?

Ms. EMREY-ARRAS. It's determined by looking at what the price would be for people who have how would I say this, if you have unrelated people who are looking at a good, it's their interest in what they think a fair price should be. It's a price that would be comparable with other prices on the market.

It's not a price that's inflated to benefit an insider.

Mr. BOWMAN. Got it. And what would be the grounds for the IRS denying an application?

Ms. EMREY-ARRAS. If they did find improper benefits. So, for example if they found that the price of the college was inflated beyond market value to benefit an insider, they could deny the application for tax exempt status.

Similarly, if they're finding other kinds of arrangements that look like there's improper benefit, so if you have service contracts, or leases, or what have you where it looks like individuals are improperly benefiting, and they're being paid above market rates to the detriment of the tax-exempt institution, that could be cause for denying the application.

Mr. BOWMAN. I thought so. Thank you so much. My next question is to Ms. Cao. You've written about the Department of Education's process for approving for-profit conversions. Why can't the Department of Education just rely on the IRS determination?

Ms. CAO. Thanks for the question. So, we've heard for-profit schools complain that they're being unfairly regulated based on tax

status, and I just want to clear up the record. The Department of Education does not regulate entities based on tax status. They regulate entities based on the risks that are posed to students and taxpayers based on whether an institution is a revenue extracting institution, or a revenue reinvesting institution.

So, the department looks at tax status because if the IRS has already determined that an institution is extracting revenue for insiders, that means the Department of Education doesn't need to re-address that ground. That institution has disqualified itself.

However, the Department of Education's review goes one step beyond that. I had mentioned that it has a three-part test, an IRS review is just one prong of that three-part test. The Department of Education really owes a greater duty to students to protect them from institutions that are going to extract the revenue instead of investing it in their education.

And you know I think one of the reasons for that is if the IRS messes up it can go back and collect back taxes with interest. But if the Department of Education messes up, students don't have that chance to take back those years of their lives, or in most cases take back the Pell grants, the loan debt, and the military benefits they've used in an institution that lied to them.

Mr. BOWMAN. Thank you. And what resources would the Department of Education need to reliably make these determinations moving forward?

Ms. CAO. I think that the resources are a part of the problem, and the GAO report identified some of the ways in which the Department of Education is starting to organize its resources to better address the issue of these conversions.

But I think the department as well needs to use all the tools in its toolbox, including things like personal liability when there are insiders that are extracting profit to the point where they're ripping off students and driving institutions into bankruptcy.

I think the department also needs to focus a little bit on the fiduciary duty that institutions owe to the Department of Education, and to taxpayers. When they sign that agreement to take Title IV dollars from taxpayers, they're agreeing to be fiduciaries to the Department of Education, and that aligns well when non-profit board of directors are already fiduciaries to educational purposes.

But for-profit directors are fiduciaries to their investors, and there's a misalignment there.

Mr. BOWMAN. Thank you so much and I yield back.

Chairman SCOTT. Thank you. The Gentlemen from Wisconsin Mr. Pocan.

Mr. POCAN. Thank you, Mr. Chairman. I appreciate it. Thanks to the witnesses. You know I think I've been on this committee when I first got to Congress and I'm glad to be back on the committee, but you know there's plenty of bad behavior by many of the for-profit entities. I think that's pretty undeniable, but I also think we have to recognize that some of these entities, especially the ones converting to non-profits, some are doing the right thing, and some are very much not doing the right thing.

Grand Canyon, Purdue, Kaplan, there's a couple great examples of companies that I think aren't primarily educational institutions, they're profit-making entities period. I think it's hard to argue.

Other than that, and I guess I'm personally less concerned about leadership in a conversion because I think many times some of the folks in leadership have the expertise.

I would expect that they would be there for continuity, especially in a family held business. You're going to expect to see that. But what I am concerned about is where the abuses occur, where we see this split of having a non-profit and a profit entity especially, seems to be really problematic.

Concerned on also performance. And let me ask a few questions if I could of Ms. Emrey-Arras, since you did the report to the GAO. Did you look at all the performance as you looked at this? So, what the completion rates are for students?

Ms. EMREY-ARRAS. We did not.

Mr. POCAN. Are you intending to do an additional study on that?

Ms. EMREY-ARRAS. We're open to new requests from the committee if the committee is interested in that.

Mr. POCAN. Yes, I think it would be interesting right, because that's a real key metric for us to know how things are performing. How about this question that I've learned of the profit, so an entity has a profit in a non-profit entity operating? I don't quite fully understand how that's not also known as a scam, and then there's other entities again who are truly non-profit, and now they're all getting painted with one brush.

And I worry about we're hurting those that are trying their very best to do the right thing in the conversion, versus the ones that are clearly trying to get around the system. Did you look specifically at some of the abuses between the profit and non-profit dual entities moving forward?

Ms. EMREY-ARRAS. We looked at some of the financial statements and found issues that raised red flags for us. So, if you're looking at situations where you know a president of a non-profit college is also engaging in lots of service contracts with the for-profit college which the president also owns, that can raise issues.

Leasing arrangements, other situations like that can raise red flags about whether or not those are really you know good arrangements in the best interest of the non-profit college, or whether they're there to improperly benefit insiders.

Mr. POCAN. So does anyone look at that for example, the fair market value. If someone is leasing, I fully understand if a family had it and they had property and now they're leasing it back. There's fair market value or there's not. Does anyone actually look at that through the process, either education or IRS?

Ms. EMREY-ARRAS. Well, the IRS is supposed to scrutinize transactions involving insiders for just that reason, to determine if there is improper benefit. And if there is, that can be grounds for denying an application for tax exempt status. Similarly, the Department of Education is looking at that issue now.

Previously they didn't, as Dr. Fox had raised the issue about you know previous years, we found that the Department of Education has not always done this. We looked at some cases prior to 2016 and found red flags, but officials there weren't looking for them.

So yes, it's something that they are looking at now, and we think that that's a good thing.

Mr. POCAN. And the IRS doesn't do that aggressively, would that be fair to say?

Ms. EMREY-ARRAS. That was our interpretation when they didn't have the sales price and approved the transactions, nonetheless.

Mr. POCAN. So, it sounds like from the conversation, and I hope I'm paraphrasing this correctly, that it sounds like more power should really go to the Department of Education who actually understands educational outcomes rather than the IRS because this is not really about a financial transaction per se in the long-run, it's about educating students.

Were there specific recommendations that you've made on how we can beef up what Department of Education does versus IRS?

Ms. EMREY-ARRAS. So, we made recommendations to both Federal agencies. Our focus was really on a Federal oversight, so we made recommendations to the IRS on what the IRS could do better to shore up that oversight, and then we also made a recommendation to the Department of Education on what it could do better.

And we thought that the area of growth for the Department of Education was really in that monitoring after school is approved to make sure that they're really operating as a non-profit and that there's no improper benefit going on.

Mr. POCAN. Great. I yield back Mr. Chairman thank you.

Chairman SCOTT. Thank you. Let's see, the Gentleman from Kentucky Mr. Yarmouth.

Mr. YARMOUTH. Thank you, Mr. Chairman. I also want to thank all the witnesses. We've been going on 4 hours now, and I appreciate all of your responses. I know at the beginning the Ranking Member questioned whether we should be having this hearing, and I will say that it seems to me this has been a very useful and thoughtful discussion with a lot of good questions from all sides.

And I've learned a lot myself, and had some questions raised as well. But it seems to me for instance, I think it was the GAO report that had said in 2018 and in 2019 the for-profit conversions received almost 2 billion dollars-worth of Federal aid. So, there's a significant amount of money at stake here, taxpayer money, so I think this is a very important discussion.

Thinking about I want to go back to what Mr. Grothman discussed, and clearly, I think there are good reasons for a for-profit to merge to a non-profit. I don't think there's any debate about that. But there are also some pretty nefarious ones, so it seems to me that in certain situations yes, we might have a principle who's built a for-profit institution, and then his kids or friends don't want to carry it on, so he or she would want to convert it for a perfect legitimate reason.

But it also seems there could be situations where he's just trying to cash out, and essentially lay off the risk, get rid of the risk and put it all in non-profit and cash out when you can. And whether or not they're improper benefits, which in these situations seem more like self-dealing, at least some of the examples we have.

Improper benefits seems like a euphemism for self-dealing here. But I want to turn to Professor Galle. In your testimony you talked about how private foundations actually prohibit many of these insider transactions because the assumption is that any insider

transaction is going to be inherently unfair to the non-profit and that it would be very difficult to police.

It seems to me there has been some confusion, at least in my mind, during some of the testimony as to what is prohibited now, what is not prohibited now. So, my question to you Professor Galle is all right, are those restrictions on private foundations, would some of those be useful when we're talking about other non-profits, especially non-profit educational institutions?

Mr. GALLE. Thank you, Congressman. I do think they would be useful, or something like them. So private foundations are charities that get their support from just a few people, and they're not schools typically. And so, the assumption is there aren't a lot of eyes on those transactions.

And so, it's difficult to be sure that they're fair to the charity. And the situations that we've heard about, and we read about in the GAO report, are situations where it's hard to believe that these transactions could possibly be fair to the charity or to the students who believed that they're getting an education at a real non-profit school.

And so, I think that both Ed and the IRS should approach a deal between a charity that was founded by the same person who's lending it money with some real suspicion. And as I discussed before, this is an excellent way for the seller to make the school a prisoner of their debts, or as you said, to cash out and eliminate their risk.

So, I think being skeptical at least of these transactions is appropriate here.

Mr. YARMOUTH. Well, I have no other questions. I want to thank the witnesses again, and again Mr. Chairman thank you for holding the hearing. I've learned a lot and I think it's been very useful. I yield back.

Chairman SCOTT. Thank you. I don't see anyone else seeking recognition, so I'll recognize myself for 5 minutes. Professor Galle in your research you said the Grand Canyon University pays 95 percent of its revenues to its former owner through loan payments and servicing contracts, and therefore should not have been granted IRS tax exempt status.

Is there reason for there to be a different standard, or is there a different standard between the IRS non-profit status, and Department of Education non-profit status?

Mr. GALLE. Thank you, Mr. Chairman. That 95 percent finding was from GAO, and I relied on their findings. So, the IRS applies a different standard because their mission is not to protect students. The IRS was very reluctant to say that an organization wasn't charitable and didn't get tax exemption.

Because if they said that the charity would close its doors. And Congress responded to that by creating a new regime in the late 90's called the Intermediate Sanctions Regime. And that regime tells the IRS don't try to revoke organization's tax-exempt status. Don't decide whether they're really charitable or not.

Your main job is just to assign penalty taxes on people who extract extra benefits. And so, the IRS isn't looking at these transactions to determine whether the organization is really non-profit and really has an incentive to maximize students over revenues. And so those fundamentally are different standards.

There are doctrines that IRS could conceivably employ if it were to look very closely at these transactions, and I think you know, a transaction like Grand Canyon is so blatant that it should fail even in the scrutiny of the IRS.

Chairman SCOTT. Doesn't the Department of Education have a different standard?

Mr. GALLE. It should. And the Department of Education 90/10 and gainful employment are there to make sure that organizations with incentives to line their own pockets are subject to higher standards and more accountability. And that's not something that IRS does.

So, IRS isn't looking out for those interests. Ed needs to establish its own standards, identify which schools are the ones that should be subject to closer scrutiny and make sure those schools get the scrutiny.

Chairman SCOTT. Thank you. Dr. Emrey-Arras we've talked about inflated purchase prices. What are some of the other ways you can benefit from an ongoing transaction—ongoing insiders can benefit from the actual transaction, and how can they benefit in getting money after the transaction?

Ms. EMREY-ARRAS. Right. So, there are two opportunities for abuse. So, there's an initial opportunity with the purchase price of the college where insiders could intervene and rig it so that they get more money than the fair value of the college, and then they pocket the difference.

The other opportunity is subsequent to the purchase of the college. They could engage in extensive service contracts with the college, or lease agreements. You might have the former for-profit owners like leasing you know land or facilities to the now non-profit college.

And the terms of those leases or contracts may not be favorable to the non-profit college, and they may not be fair market value. They may also improperly benefit the insiders.

Chairman SCOTT. Thank you. Ms. Cao we've heard about these high salaries. What's the difference between a high salary for a college president and insiders taking money out of the operation?

Ms. CAO. Sure. So, one difference is whether the college has gone through an independent review and hiring process, or whether an insider is extracting revenue for his personal benefit from non-profit that he essentially controls. And I think the later situation is what we've seen at some of these for-profit conversions.

You have shareholders who are benefiting from a conversion to non-profit status, and any time that shareholders are promised a pay day, from non-profit status, I think that tells you all you need to know.

Chairman SCOTT. Well in the case of those high salaries, if the president essentially because he's an insider is setting his own salary rather than an independent board, is that a different situation?

Ms. CAO. Yes. The president is not just setting his own salary. He's guiding the administration of the school to maximize the revenue that he's taking out and paying himself with or keeping his equity. And that means steering the school toward higher tuition prices and lower investments in a student's education.

Chairman SCOTT. Well, thank you. And I want to thank all of the witnesses for being with us today. I want to remind my colleagues that pursuant to committee practice, materials for submission for the hearing record must be submitted to the Committee Clerk within 14 days following the last day of the hearing.

So that's by close of business May 4, preferable in Microsoft Word format. The material submitted must address the subject matter of the hearing. Only a Member of Congress, or excuse me, a Member of the committee, or the invited witnesses may submit materials for inclusion in the record.

Documents are limited to 50 pages each. Documents longer than 50 pages can be incorporated into the record by way of an internet link which you can provide to the Committee Clerk within the required timeframe, but please recognize that in the future that link may no longer work.

Pursuant to House rules and regulations, items for the record should be submitted to the clerk electronically by emailing submissions to edandlabor.hearings@mail.house.gov. Member's offices are encouraged to submit materials to the inbox before the hearing or during the hearing at the time the member makes such a request.

Again, I want to thank the witnesses for your participation. Members of the committee may have some additional questions for you, and we would ask you to respond to those in writing. The hearing record will be held open for 14 days in order to receive the responses.

I remind my colleagues that pursuant to committee practice, witness questions for the hearing must be submitted to the Majority Committee Staff within 7 days and questions must be related to the subject matter of the hearing.

I now recognize the distinguished Ranking Member for any closing statement that she might want to make, Dr. Foxx.

Ms. Foxx. Thank you, Mr. Chairman. Mr. Chairman I want to thank the witnesses for their testimony. We covered a lot of ground today and there's several things worth noting. Republicans oppose all fraud and abuse no matter the tax status of the perpetrator.

Republicans care about all students no matter what institution they attend. Republicans support reforming the HEA to make sure all students attending institutions of post-secondary education give them the chance to succeed in the workforce. In contrast, democrats want to talk about a college's legal and financial structure, not about students.

Democrats are obsessed with a perfectly legal financial arrangement that 0.1 percent of for-profit colleges pursued per year in the past 10 years. Democrats want to shut down small business in the middle of the pandemic to serve students.

Democrats are uncomfortable with the notion that not all public and non-profit colleges act in their student's or their communities' best interest, and here Mr. Chairman I'd like to insert a Time article related to this issue.

There are real issues American students and families are grappling with. Outstanding student loan debt has never been higher because college tuition rates are skyrocketing. Students are struggling to find a good job after graduation because their college is not preparing them for career success.

On-time college completion rates are abysmal. Colleges are trampling on students first amendment rights. China is stealing intellectual property and infiltrating college campuses. Families don't care about who runs a college, they do care about their ability to succeed.

We could have had a hearing today on what actually matters to our constituents, and I'm disappointed on their behalf that my democrat colleagues don't seem to care about them. I call upon my colleagues to pursue a bi-partisan path forward to reforming the Higher Education Act. I yield back.

Chairman SCOTT. Thank you. I want to thank our witnesses again for being with us today and both your testimony and our discussion have shed light on the urgent need to prevent for-profit institutions for converting to non-profit institutions at the expense of students and taxpayers.

As it's been pointed out, all are not guilty of fraud, but many are. And we've heard that the impact not just on the students but on the Federal Government could be intense. The estimate of 600 million dollars to a billion dollars in just one institution should not be ignored.

We've heard that these conversions deceive the students, decrease funding for student learning. We've also heard that virtually all the fraud in the higher education sector in the borrowed defense claims occurs in the for-profits and the covert for-profits.

The simple fact is that many of the most concerning conversions occur when there are insiders at both the non-profit and the for-profit institution. Common sense tells us these institutions are unable to engage in transactions with one another, instead the for-profit institution ends up profiting for the non-profit institution at the expense of students with fewer funds invested in their education.

These schools cannot compete on equal terms, the true non-profits, and public institutions, and as a result they often turn to fraud like we saw in the Dream Center case, that costs the Federal Government hundreds of millions of dollars. I also want to respond to some of my colleagues decided researched which relies on data from the college scoreboard which shows the publicly available consumer information is sufficient to protect students and taxpayers.

However, we know this data is not sufficient to determine a debt to earnings ratio comparable to the one used in the gainful employment rule. More importantly, we should not treat better consumer information as a replacement for strong accountability measures.

It actually should go hand in hand. And finally, I want to thank my republican colleagues for raising the need to improve the cohort default rate, the CDR, the College Affordability Act, which committee approved last Congress, would have closed the CDR forbearance loophole, measured CDR's using longer timeframes, and created a loan repayment rate to supplement the CDR.

Based on Mr. Gillen's testimony today this seems to be an area of bipartisan agreement, and I look forward to working with my republican colleagues to advance these important reforms. Moving forward I hope my colleagues on both sides of the aisle will come together to stand up for our Nation's children and our students and

enact meaningful solutions that protect students and taxpayers against deceptive for-profit schools.

If there is no further business to come before the committee without objection the committee stands adjourned. Thank you.

[Additional submissions by Ranking Member Foxx follow:]

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Cheap for Whom?

How Much Higher Education Costs Taxpayers

By Mark Schneider and Jorge Klor de Alva

Many more factors figure into the cost of a bachelor's degree than just tuition. Depending on the type of college or university, as well as its level of selectivity, taxpayers may contribute a substantial tax subsidy or, in rare cases, receive a moderate net "profit" per bachelor's degree. It is important to consider all of the costs and returns involved in higher education when considering dropout prevention and retention efforts, as well as how government subsidies are or should be distributed among colleges and universities. This Outlook is designed to fuel a discussion about the true costs of higher education and who pays for them.

Consumers are usually not troubled by the difference between price (what we pay for something) and cost (what it costs to produce it), mostly because we are concerned about the former but are generally ignorant of the latter. If we go to Walmart to buy a roll of paper towels and the price is one dollar, the fact that it may cost thirty cents to produce is generally irrelevant. Consumers are even more likely to ignore cost when government subsidies lead to little resemblance between price and cost. With a highly subsidized service such as higher education, price and cost can diverge substantially—for example, a college diploma that carries a low price tag can cost far more than people realize.

Most people recognize that the price of public universities is underwritten by subsidies that they receive through direct government appropriations, but information on the size and distribution of those subsidies across schools is usually buried in

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obscure data and reports. Most private institutions also receive government subsidies, especially through their tax-exempt status. For the best-known—and best-endowed—not-for-profit colleges and universities, such as Harvard, Princeton, and Yale, these tax subsidies can be substantial. However, although

Key points in this Outlook:

- Tuition at both public and private for-profit and not-for-profit US higher education institutions is increasing, but taxpayers are also bearing significant hidden costs.
- Average taxpayers provide more in subsidies to elite public and private schools than to the less competitive schools where their own children are likely being educated.
- High dropout and low graduation rates drive up taxpayer costs, so degree completion and retention should be a focus of US higher education reform and state and federal policy discussions.
- Business as usual in higher education is too expensive. We need new modes of delivery for higher education to reduce taxpayer costs and rein in tuition.

figures on the size and distribution of state appropriations for public colleges and universities are hard to track down, calculating tax subsidies among not-for-profit institutions is far more arduous given the lack of accessible data, as is also true with data on campuses' use of endowment fund earnings.

In this *Outlook*, we not only estimate the size of those subsidies but also show that they are distributed in such a way that the more selective a school is and the fewer low-income students it serves, the larger its taxpayer subsidy. In other words, most taxpayers are spending far more money to educate students in the country's elite institutions than they spend to support their own children at the less-selective schools they likely attend.

Before we look at the data showing the size and distribution of taxpayer subsidies, we need to lay out a quick schematic describing how schools that grant bachelor's degrees in the United States are structured.¹ The first dimension to consider is tax status and ownership (what the federal government calls "control"). Three types of control exist: public institutions (for example, the University of Nebraska, the California State University campuses), private not-for-profit institutions (Harvard University, American University, Kentucky Christian University), and private for-profit institutions (University of Phoenix, Kaplan University). More than 2,000 four-year degree-granting colleges and universities exist in the United States: around 28 percent are public; more than 60 percent are private not-for-profit; and the remaining 12 percent are private for-profit. Because public institutions tend to be larger than private schools, more students are enrolled in public colleges than in the more numerous private institutions.²

The other distinction that matters is how colleges and universities are stratified by their level of selectivity. In this report, we use the well-known rankings reported in *Barron's Profiles of American Colleges*,³ which classifies colleges and universities into six categories ranging from open-admissions schools ("noncompetitive") through the most selective ones ("most competitive").

Of the approximately 2,000 bachelor's degree-granting institutions listed in the US Department of Education's Integrated Postsecondary Education Data System (IPEDS), we were able to match almost 1,400 of them with a *Barron's* classification. Not surprisingly, selectivity data for colleges and universities fall into a typical bell curve: about 50 percent of the campuses are classified as competitive, about 6 percent as noncompetitive, and about 6 percent as most competitive.

Cross-classifying colleges and universities by the three categories of control with *Barron's* six categories of selectivity produces eighteen combinations. However, in assembling the data on which this analysis is based, we found only a few students and schools in some of the eighteen categories, so we chose to combine *Barron's* noncompetitive and less competitive categories. Moreover, all the for-profit campuses we identified were in the less competitive category. This left us with eleven categories and more than 600 schools that we analyze in this *Outlook*.⁴

In the following pages we look at how much taxpayers spend on producing bachelor's degrees in each of these types of schools and at a simple indicator of the return on those investments. We focus on direct financial benefits and costs, leaving aside the many indirect societal and individual benefits that accrue to communities and individuals because of higher education, such as better health and lower incarceration rates.

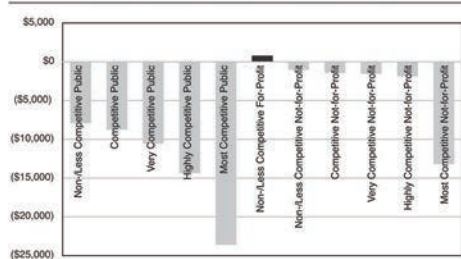
Public Institutions Cost Taxpayers More Than Private Ones

Figure 1 displays the size of annual taxpayer subsidies across the eleven categories of institutions of higher education.⁵ Not surprisingly, at any level of selectivity, public institutions receive larger taxpayer subsidies than do private ones. But two other patterns in the data are noteworthy.

First, the level of taxpayer subsidy increases with selectivity—the more elite the school, the more taxpayer money goes to the production of each bachelor's degree.

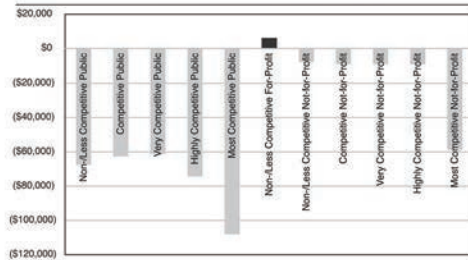
- For public institutions, there is a consistent increase across the first four levels of selectivity, with a more substantial bump in taxpayer costs in the most competitive state schools.⁶ While we have subtracted the research expenditures colleges and universities report to the federal government, a substantial amount of state money still goes to these institutions to support research activities not separately enumerated in IPEDS.⁷
- Among not-for-profit institutions, the amount of taxpayer subsidies hovers between \$1,000 and \$2,000 per student per year until we turn to the most selective institutions in the country. Among these already well-endowed institutions, the taxpayer subsidy jumps substantially to more than \$13,000 per student per year.

FIGURE 1
ANNUAL TAXPAYER SUBSIDIES PER STUDENT PER YEAR



SOURCE: Authors' calculations.

FIGURE 2
TAXPAYER SUBSIDIES PER BACHELOR'S DEGREE



SOURCE: Authors' calculations.

Second, because for-profit institutions receive no state appropriations and pay income taxes, they cost the taxpayer nothing—indeed, they return a net “profit” to the taxpayer.

Figure 2 displays the amount of taxpayer subsidies supporting the production of a bachelor’s degree. It bears highlighting that, in calculating these total subsidies, we took into account both dropout rates and the time it takes students to earn a degree.

For public institutions, taxpayers are investing more than \$60,000 for each bachelor’s degree granted in the three less competitive categories, close to \$75,000 in the highly competitive institutions, and more than \$100,000 for each bachelor’s degree granted in the most competitive flagship institutions. Note that each bachelor’s degree granted from the non- or less competitive institutions actually costs more than a bachelor’s degree from competitive institutions, which in turn costs the taxpayer slightly more than a bachelor’s degree from the very competitive public institutions. This is a function of the high costs of dropouts and the longer time to graduation for students in less selective institutions.

Taxpayer costs for bachelor’s degrees in private institutions range from a net profit of more than \$6,000 per degree from for-profit institutions to a net cost of around \$8,000 for not-for-profits in every category of selectivity except the most selective ones, where the costs jump to more than \$58,000 per degree.

As we just noted, in less selective institutions, the cost of a bachelor’s degree is affected by high dropout rates. In table 1, we estimate how much the taxpayer subsidy for a bachelor’s

degree would fall if institutions in each category decreased their dropout rate by 50 percent.

In more selective institutions, lower dropout rates translate into very low savings because so few students leave. But for colleges and universities in the three less selective categories, the taxpayer cost per degree would fall by 20–30 percent. In short, when a student drops out of college, both the student and the taxpayers incur high added costs.

TABLE 1
REDUCING DROPOUT RATES WOULD REDUCE TAXPAYER COSTS FOR DEGREES

	Barron's Non-/Less Competitive		Barron's Competitive		Barron's Very Competitive		Barron's Highly Competitive		Barron's Most Competitive		
	For-Profit	Public	Not-for-Profit	Public	Not-for-Profit	Public	Not-for-Profit	Public	Not-for-Profit	Public	
Total Taxpayer Cost/ (Benefit) per Bachelor's Degree	(\$6,100)	\$67,600	\$8,000	\$62,600	\$8,700	\$61,200	\$8,600	\$74,300	\$8,800	\$108,000	\$58,700
With Dropouts Reduced by 50 Percent	(\$4,700)	\$53,000	\$6,200	\$51,600	\$6,700	\$54,300	\$7,600	\$68,800	\$8,300	\$103,500	\$56,500
Percentage of Taxpayer Cost Attributable to Higher Dropout Rate	23%	22%	23%	18%	23%	11%	12%	7%	6%	4%	4%

SOURCE: Authors' calculations.

A Perverse System of Taxpayer Support

We have documented substantial taxpayer subsidies to students in most colleges and universities—through either direct appropriations to public institutions or tax subsidies for private not-for-profit schools. The federal government also supports students directly through the Federal Pell Grant program, which is designed to allow students with financial need to attend college when they might otherwise not be able to.

Low-income students—comprising the fastest-growing segment of the population—are concentrated in colleges and universities that get the lowest levels of taxpayer support. We believe that in this time of fiscal shortages and challenges to higher education, any debate on the best distribution of scarce funds for federal grants or state subsidies must be informed by these data.

Taxpayer Return on Investment

Bachelor's degree holders earn substantially more than students with high school degrees: according to the US Census Bureau, young adults between the ages of twenty-five and thirty-four with a college degree, working year-round, earn around 40 percent more than someone with some college education who has not completed a degree and around two-thirds more than someone with just a high school diploma.⁸ These annual differences accumulate over time, and the lifetime earnings of a college graduate can exceed those of a high school graduate by as much as half a million dollars.⁹

Taxpayers share in this bounty through the higher taxes that college graduates pay. These higher taxes can be considered a return on the investment taxpayers are making in students earning those degrees. How big is that return?

Using PayScale data, we calculated an earnings stream for graduates from each campus in our sample and compared this to the earnings stream of someone with only a high school diploma to estimate the added value of a degree from each school in terms of lifetime earnings.¹⁰ Then, given that most income for most graduates is taxable, we applied existing federal tax rates to these additional earnings to estimate how much the federal taxpayer benefits from the added income resulting from the bachelor's degree. Because state income taxes average about 25 percent of federal tax collections, we increased the calculated federal tax by 25 percent to estimate net taxpayer gain.¹¹ Because these benefits are calculated over a graduate's work life, we took the present value of this stream of earnings.¹²

In the first substantive column of table 2, we report the additional tax benefits bachelor's degree holders generate through their higher income stream.¹³ The tax benefits increase substantially with selectivity of the degree-granting institution. In most categories, graduates of public institutions make more and pay more income taxes than do graduates from private institutions; this steady increase turns into a large bump among graduates of the most selective private institutions, where a degree from a marquee private school pays off substantially for both the graduate and the taxpayer.¹⁴

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In the next column of table 2, we report the taxpayer cost per degree (previously displayed in figure 2). The final column is the net benefit/cost to the taxpayer for the bachelor's degree from each of the eleven categories of schools. Taken together, taxpayers experience a net benefit in nine of the eleven categories. Not surprisingly, the data show that given the much higher investment in public colleges and universities, taxpayers' return on investment from public colleges and universities is far lower than the return from private schools.

Let us now look at the two categories of schools that represent a net loss to the taxpayer. First, in the non-/less selective schools, public institutions are in the red. Although both for-profit and not-for-profit private campuses have strong pay-offs to the taxpayer, high dropout rates mean these public campuses are costly, even as they receive the lowest tax subsidies. On the other end of the selectivity continuum, the most competitive public campuses also generate net losses to the taxpayer. In contrast to less selective campuses, these public flagship campuses have low dropout rates. Their losses to taxpayers, therefore, are generated not through the lack of student success but rather through the higher costs associated with research institutions, such as higher-paid faculty teaching fewer courses.

We recognize the unique role of state flagships in producing new knowledge and helping the United States maintain its competitive edge in the world economy. Nonetheless, legislators, governors, and other decision makers should be fully aware of just how much these institutions cost to run.

The country has embarked on a serious effort to improve college graduation rates, supported by large grants from foundations, with the full blessing of the Obama administration and state governors. To the extent that this "completion agenda" is met, the high cost taxpayers incur supporting bachelor's degrees in the non- and less competitive colleges should come down. In contrast, the issue of the high cost of supporting our public flagships has not yet registered constructively in public discussion. Because flagship campuses may not be the best place to increase undergraduate enrollment, given

TABLE 2
TAXPAYERS' BENEFIT FROM THE HIGHER INCOME
OF COLLEGE GRADUATES

Sector	Lifetime additional income taxes paid	Taxpayer benefit/(cost) per bachelor's degree	Net benefit/(cost) to taxpayer
Non-/Less Competitive			
For-Profit	\$54,800	\$6,100	\$60,900
Public	\$60,100	(\$67,600)	(\$7,500)
Not-for-Profit	\$52,100	(\$8,000)	\$44,100
Competitive			
Public	\$66,700	(\$62,600)	\$4,100
Not-for-Profit	\$58,200	(\$8,700)	\$49,500
Very Competitive			
Public	\$78,100	(\$61,200)	\$16,900
Not-for-Profit	\$78,600	(\$8,600)	\$70,000
Highly Competitive			
Public	\$97,100	(\$74,300)	\$22,800
Not-for-Profit	\$93,600	(\$8,800)	\$84,800
Most Competitive			
Public	\$98,700	(\$108,000)	(\$9,300)
Not-for-Profit	\$147,100	(\$58,700)	\$88,400

SOURCE: Authors' calculations.

per-student costs, their role in the college completion agenda needs considered attention.

Conclusions

Taxpayers have long supported colleges and universities, mostly through subsidies for state institutions and tax breaks for private colleges. Unfortunately, government budgets are currently stretched far beyond their limits, with higher education demanding a larger portion of a shrinking pie. As states cut their higher education budgets, students, families, and policymakers need better information about the level of support colleges and universities are actually getting from the government—and what students and taxpayers are getting in return.

Based on the data presented in this *Outlook*, several broad policy considerations seem appropriate:

- First, given the financial return to graduates for each completed bachelor's degree and the high cost of dropouts, the country must focus its resources and

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policies on increasing degree completions and retention. One way to do this is for states to make a substantial share of their appropriations based on performance rather than enrollment. A complementary process is for states to participate in the Alliance of States initiative of Complete College America and actively work to make college completion a top policy priority.¹⁵ The US Department of Education can contribute to this process by making continued Pell grant eligibility subject to periodic performance reviews.¹⁶

- Second, if the country is to retain its competitive edge, it must reverse the current policies that result in providing the lowest levels of taxpayer support to the institutions that enroll the highest percentage of low-income, nontraditional, and minority students—the fastest-growing segments of the population.
- Third, the Lumina Foundation for Education's *Guide for State Policymakers* urges states to help expand and strengthen "lower-cost, nontraditional education options" through modification of their regulations so that these "education options . . . that operate across state lines, on-line institutions and competency based institutions" can "lower cost to states and the taxpayer."¹⁷ While some for-profit colleges and universities already fit this description, state policymakers should also look more closely at other models, including those that are more radical departures from business as usual, such as StraighterLine or Carnegie Mellon University's Open Learning Initiative. These steps and more need to be taken to transform higher education into an affordable, successful endeavor because, as is becoming clear to many, "business as usual" will no longer work.¹⁸
- Finally, because the price of admission to the middle class through higher education is beyond the reach of a growing number of Americans, state and federal policy discussions concerning how and whom to fund must be informed by reliable data drawn from institutions across all types of control and levels of selectivity. These data must be in the public domain and must address what a degree actually costs both students and taxpayers and who actually pays for these degrees.

Appendix: Measuring Taxpayer Costs and Benefits

Our estimates involved identifying money each campus receives from the government and subtracting the sum of these incoming funds from the funds each campus sends to the government. The underlying data are almost all from IPEDS. For some calculations, specifically noted below, we needed to estimate tax rates. In this appendix, we also describe the variables we collected and our calculations. Tables A1 and A2 report the various flows of funds between the government and campuses grouped into the eleven reporting categories. The source of these funds is noted in parentheses after each category.

Taxpayer Expenses via Government Subsidies

Direct Government Support/Student Grants for Tuition (IPEDS):

- For public institutions: Government support, including federal operating grants and contracts, plus federal appropriations, including the sum of Pell, Academic Competitiveness, and National Science and Mathematics Access to Retain Talent (SMART) grants
- For private not-for-profit institutions: Government support, including federal grants and contracts, plus federal appropriations, including the sum of Pell, Academic Competitiveness, and National SMART grants
- For private for-profit institutions: Government support, including the sum of Pell, Academic Competitiveness, and National SMART grants

State and Local Subsidies (IPEDS): State and local support received by institutions—includes state grants and contracts plus local or private grants and contracts as reported by IPEDS. Public and private not-for-profit institutions also receive state and local appropriations, while private for-profit institutions do not.

Government Subsidies via Students (Office of Federal Student Aid): The federal government traditionally provides two types of direct student loans: subsidized and unsubsidized.¹⁹ The primary difference is the point at which interest begins to accrue. No interest accrues on a subsidized loan, and no principal is due until the end of the six-month grace period that begins after a student graduates, leaves the institution, or drops below half-time enrollment. Therefore, the government-subsidized

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TABLE A1
NET COST OR BENEFIT TO TAXPAYERS PER DEGREE

	Barron's Non- and Less Competitive			Barron's Competitive	
	For-Profit	Public	Not-for-Profit	Public	Not-for-Profit
Number of Students	106,755	582,785	67,997	1,889,168	503,017
Percentage of Undergraduate Students	78%	88%	76%	86%	81%
Amount Received from Government					
Student Grants for Tuition	\$163,000,000	\$841,000,000	\$43,000,000	\$3,000,000,000	\$571,000,000
State and Local Subsidies	\$34,000,000	\$4,000,000,000	\$18,000,000	\$15,000,000,000	\$145,000,000
Federal Government Subsidies (excluding student grants)	\$45,000,000	\$36,000,000	\$6,000,000	\$108,000,000	\$45,000,000
Sum Amount Received from Government	\$243,000,000	\$5,000,000,000	\$67,000,000	\$19,000,000,000	\$763,000,000
Total Amount Received from Government in 2010 Dollars	\$246,000,000	\$5,000,000,000	\$68,000,000	\$19,000,000,000	\$772,000,000
Less Amount Spent on Research	\$0	\$741,000,000	\$4,000,000	\$3,000,000,000	\$136,000,000
Net Amount Received from Government	\$246,000,000	\$4,000,000,000	\$64,000,000	\$16,000,000,000	\$636,000,000
Amount Paid to Government					
Accruing Principal	\$126,000,000	\$86,000,000	\$17,000,000	\$306,000,000	\$172,000,000
Taxes Paid/Forgone	\$200,000,000	(\$182,000,000)	(\$23,000,000)	(\$641,000,000)	(\$241,000,000)
Amount Paid to Government	\$326,000,000	(\$95,000,000)	(\$5,000,000)	(\$335,000,000)	(\$69,000,000)
Total Amount Paid to Government in 2010 Dollars	\$331,000,000	(\$97,000,000)	(\$6,000,000)	(\$339,000,000)	(\$70,000,000)
Total Annual Benefit/(Cost) to Taxpayers	\$84,000,000	(\$4,000,000,000)	(\$70,000,000)	(\$16,000,000,000)	(\$706,000,000)
Annual Benefit/(Cost) to Taxpayers per Student	\$780	(\$7,800)	(\$1,000)	(\$8,700)	(\$1,400)
Weighted Total Benefit/(Cost) to Taxpayers per Degree	\$6,100	(\$67,600)	(\$8,000)	(\$62,600)	(\$8,700)

SOURCE: Authors' calculations.

TABLE A2
NET COST OR BENEFIT TO TAXPAYERS PER DEGREE

	Barron's Very Competitive		Barron's Highly Competitive		Barron's Most Competitive	
	Public	Not-for-Profit	Public	Not-for-Profit	Public	Not-for-Profit
Number of Students	1,251,948	416,400	593,319	253,750	96,018	433,570
Percentage of Undergraduate Students	85%	82%	78%	86%	76%	73%
Amount Received from Government						
Student Grants for Tuition	\$5,000,000,000	\$462,000,000	\$4,000,000,000	\$519,000,000	\$1,000,000,000	\$8,000,000,000
State and Local Subsidies	\$13,000,000,000	\$169,000,000	\$9,000,000,000	\$116,000,000	\$1,000,000,000	\$862,000,000
Federal Government Subsidies (excluding student grants)	\$65,000,000	\$32,000,000	\$28,000,000	\$17,000,000	\$4,000,000	\$24,000,000
Sum Amount Received from Government	\$18,000,000,000	\$664,000,000	\$13,000,000,000	\$654,000,000	\$3,000,000,000	\$9,000,000,000
Total Amount Received from Government in 2010 Dollars	\$18,000,000,000	\$673,000,000	\$13,000,000,000	\$662,000,000	\$3,000,000,000	\$9,000,000,000
Less Amount Spent on Research	\$6,000,000,000	\$363,000,000	\$5,000,000,000	\$476,000,000	\$1,000,000,000	\$9,000,000,000
Net Amount Received from Government	\$12,000,000,000	\$289,000,000	\$7,000,000,000	\$185,000,000	\$1,000,000,000	\$807,000,000
Amount Paid to Government						
Accruing Principal	\$225,000,000	\$142,000,000	\$104,000,000	\$84,000,000	\$19,000,000	\$144,000,000
Taxes Paid/Forgone	(\$836,000,000)	(\$488,000,000)	(\$754,000,000)	(\$369,000,000)	(\$337,000,000)	(\$5,000,000,000)
Amount Paid to Government	(\$611,000,000)	(\$345,000,000)	(\$649,000,000)	(\$284,000,000)	(\$318,000,000)	(\$4,000,000,000)
Total Amount Paid to Government in 2010 Dollars	(\$618,000,000)	(\$349,000,000)	(\$657,000,000)	(\$288,000,000)	(\$322,000,000)	(\$4,000,000,000)
Total Annual Benefit/(Cost) to Taxpayers	(\$13,000,000,000)	(\$639,000,000)	(\$8,000,000,000)	(\$474,000,000)	(\$2,000,000,000)	(\$5,000,000,000)
Annual Benefit/(Cost) to Taxpayers per Student	(\$10,500)	(\$1,500)	(\$14,300)	(\$1,800)	(\$23,600)	(\$13,200)
Weighted Total Benefit/(Cost) to Taxpayers per Degree	(\$61,200)	(\$8,600)	(\$74,300)	(\$8,800)	(\$108,000)	(\$58,700)

SOURCE: Authors' calculations.

Title IV loans (Federal Family Education Loans²⁰ and Direct Loans) represent a cost to the federal government and the taxpayers. We estimate the costs of this subsidy to be the equivalent of the average three-month Treasury bill rate, which was 2.91 percent at the time of our analysis,²¹ times the total subsidized loan disbursements made during the 2007–08 academic year.²² As with other calculations, we converted this into 2010 dollars.²³

Research Expense (IPEDS): These expenditures are included in funds received from the government. Since these funds are dedicated for specific activities that usually have little to do with bachelor's degree production, we subtracted them from the amount received from the government.

Funds Paid to Government

Interest Paid by Students on Loans: We used data from 2007–08. We did not calculate the interest earned on unsubsidized and PLUS (parent and graduate student) loans that accrued while the student was in school on a net present value basis because these dollars are rolled into the principal loan balance in that same period and subject to future interest payments. Because the government uses collection methods that are hard for an individual to avoid (for example, wage garnishment), we assumed that the government collects the full principal owed and did not discount the interest earned.²⁴ This is consistent with the federal budget, which also assumes that the government collects 100 percent on average for each Title IV dollar loaned ("principal"), regardless of default rates.²⁵ Given that the interest accrued while students are in school is included in the principal, we assumed that the taxpayer benefits by an amount equal to the interest charged on the different types of loans.²⁶

We have combined tax expenditures (forgone taxes) and taxes paid to measure the net tax flow between institutions and government. We are likely overstating the extent of tax expenditures because some institutions make voluntary payments in lieu of property taxes, but IPEDS does not collect these data and we have found no other central data source that reports these payments.

Tax Expenditures and Taxes Paid: Public and private not-for-profit institutions are tax-exempt and do not pay tax on investment income, increases to endowments (gifts), or operating revenues. For-profit institutions pay sales tax on revenues (which include Pell grants and Title IV

loans) and income taxes on operating profits and investment income. In this study, we treated forgone tax payments as a cost to the taxpayers (that is, tax expenditures) while payment of taxes represents a benefit received by the taxpayers.

- **Forgone Taxes on Investment Income:** According to the IRS, the standard federal corporate tax rate is 35 percent for income over \$18.3 million.²⁷ State corporate tax rates vary from zero in some states to 9.99 percent in Pennsylvania. We used 5 percent as an estimate of the average state corporate tax rate across the country and applied this rate to all education sectors.²⁸
- **Forgone Taxes on Endowment Contributions:** Although gifts from foundations are not taxable, we assumed that other contributors to university endowments would generate taxable income levels in at least the 25 percent federal tax brackets. Many of the contributing individuals likely have taxable income levels that fall in higher tax brackets, but we used this rate as a conservative estimate for calculating these forgone taxes.
- **Forgone Sales and Other Taxes:** Because we did not have sufficient information to calculate exact forgone sales and use taxes for public and private not-for-profit universities, we used a 0.5 percent use tax rate to estimate the forgone sales and other taxes for other education sectors. The actual sales and other taxes would likely be higher for public and private not-for-profit universities if they were charged.²⁹

Total Taxes Paid: Private for-profit universities pay corporate tax on investment income, income tax on total taxable revenue (net of operating expenses),³⁰ and sales tax.³¹ As noted earlier, we consider payment of taxes a benefit received by the taxpayers. Total taxes paid equal the sum of:

- *Tax on Investment Income* =
Investment income \times (35 percent + 5 percent)
- *Tax on Corporate Profits* =
Taxable revenue \times 10.8 percent
- *Sales and Other Taxes* =
Taxable revenue \times 0.5 percent

We added these numbers and adjusted the 2008 numbers for inflation to create a measure of the total amount paid to the government in 2010 dollars.

Total Annual Benefit (Cost) to Taxpayers: This is the sum of money paid to and money received from governments as measured above, in 2010 numbers.

With these overall sums, we calculated total annual benefit/cost per student, dividing the total annual benefit/cost by the number of full-time enrolled students. Tables A1 and A2 show the flow of money for the eleven categories of schools.

Notes

Authors' note: The data used in this report are drawn from a larger study by the authors entitled *Who Wins? Who Pays? The Economic Returns and Costs of a Bachelor's Degree* (Washington, DC: American Institutes for Research and San Francisco: Nexus Research and Policy Center, 2011), www.air.org/files/WhoWins_bookmarked_050411.pdf (accessed September 14, 2011).

1. Our analysis is focused on bachelor's degree-granting institutions and does not include community colleges, an increasingly important part of higher education in the United States.

2. Based on full-time equivalent undergraduate enrollment, public colleges and universities account for almost two-thirds of all students.

3. See Barron's Educational Series, Inc. *Barron's Profiles of American Colleges* (Author: Hauppauge, NY, 2009, 2011).

4. For more detail on the sample and methods used, see Klor de Alva and Schneider, *Who Wins? Who Pays?*

5. The appendix to this *Outlook* lists each variable we used in our calculations and describes all calculations we used to generate our estimates.

6. These are the so-called "flagship" campuses, which are the best-known campuses in state systems. Examples include the University of North Carolina at Chapel Hill, the University of Michigan at Ann Arbor and the University of California at Berkeley.

7. For just how much this may be costing taxpayers in Texas, see Richard Vedder, Christopher Matgouranis, and Jonathan Robe, *Faculty Productivity and Costs at the University of Texas at Austin: A Preliminary Analysis* (Washington, DC: Center for College Affordability and Productivity, 2011), www.centerforcollegeaffordability.org/uploads/Faculty_Productivity_UT-Austin_report.pdf (accessed September 8, 2011).

8. See US Census Bureau, "Current Population Survey, 2010 Annual Social and Economic Supplement," www.census.gov/hhes/www/cpstables/032010/perinc/new04_001.htm (accessed September 12, 2011).

9. See Klor de Alva and Schneider, *Who Wins? Who Pays?*, and Mark Schneider, "How Much Is That Bachelor's Degree

Really Worth?" *AEI Education Outlook* (May 2009), www.aei.org/outlook/100034.

10. For an explanation of these data, see PayScale, "Methodology Overview, 2011–2012 PayScale College Salary Report," www.payscale.com/best-colleges/salary-report.asp (accessed September 12, 2011).

11. Note that we are using only federal income taxes and not including payroll taxes, which would also increase with higher income up to the annual cap.

12. We calculate lifetime returns respectively building on the methodology used by the US Census Bureau. See Jennifer Cheeseman Day and Eric C. Newburger, "The Big Payoff: Educational Attainment and Synthetic Estimates of Work-Life Earnings," *Current Population Reports* (July 2002), www.census.gov/prod/2002pubs/p23-210.pdf (accessed September 12, 2011), as modified by Mark Kantrowitz, "The Financial Value of a Higher Education," *Journal of Student Financial Aid*, 37, no. 1 (2007): 19–27. We estimated expected earnings over an individual's work life using various expected annual growth rates in salaries for college graduates calculated for each school sector. We applied these growth rates starting with salaries at ages twenty-five through forty-two. From that age on, we used growth rates calculated with census income data to estimate the salary levels in the salary growth profile until age sixty-five (following the census, we used a work life of forty years). To determine the net present value of this calculated stream of earnings, we used the 2010 thirty-year Treasury bill interest rate as the discount rate (4.5 percent).

13. Note that we are capturing only income taxes. Other taxes that likely increase with income (such as sales and property taxes) are not measured.

14. We are not measuring the added value of attending an Ivy League (or similarly selective) institution.

15. See Complete College America, "The Alliance of States," www.completecollege.org/alliance_of_states (accessed September 12, 2011).

16. For example, see Jorge Klor de Alva, "The Future of Pell Grants: 6 Views," *Chronicle of Higher Education* (March 20, 2011), www.chronicle.com/article/The-Future-of-Pell-Grants-6/126820 (accessed September 12, 2011).

17. See Lumina Foundation for Education, *Four Steps to Finishing First in Higher Education: Step 3* (2009), www.collegeproductivity.org/sites/default/files/FourSteps_Step%203_NonTradit-1.pdf (accessed September 12, 2011).

18. See the papers presented at the American Enterprise Institute's conference on "Degrees of Difficulty" (February 15, 2011), www.aei.org/event/100346.

19. Note that campuses do not receive student loans—they go to students. However, we have debited taxpayers with

the interest subsidies because these loans can be received only by students.

20. The Federal Family Education Loan Program ended in 2010.

21. We calculated the average three-month Treasury bill rate as the average of three-month treasury constant maturity rates from June 2008 to July 2009. Data were obtained from US Department of the Treasury, "Resource Center," www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/default.aspx (accessed September 14, 2011).

22. See Federal Student Aid, "Data Center," <http://federalstudentaid.ed.gov/datacenter/programmatic.html> (accessed September 13, 2011). Under the Loan Volume heading, two programs are listed: the Direct Loan and Federal Family Education Loan programs. Under each program is a drop-down menu; we selected "AY2007-2008, Q4" for each and downloaded the associated reports. We pulled amounts from the Award Year Summary tab, and used the amounts listed in the \$ of Disbursements column in the calculation for each relevant category (Subsidized, Unsubsidized, Parent Plus, and Grad Plus).

23. The cost of principal is, of course, borne by the student borrower.

24. While one could argue that these future interest dollar payments should be discounted, we did not consider them because of the limitations on accurately gathering the measures we would need, such as average length of outstanding student loans and average student loan balances. What we do know is that the government collects 100 percent of the principal balance, and that is all that is included in our analysis.

25. We used a uniform 100 percent rate, although the rates likely vary across school types. The government does not report its collection rates by individual schools or by sector. Also, the recovery rate on defaulted loans is 112 percent of the default claim (gross recovery rate) and 85 percent of the net of collection charges on a net present value basis.

26. We calculated the interest paid by the type of loan issued and the prevailing interest rate in 2008 for each of the programs: subsidized loans, 2.91 percent; unsubsidized loans, 6.8 percent; Parent Plus, 8.4 percent for not-for-profit and for-profit; public institutions, 8.2 percent; Grad Plus, 8.5 percent for not-for-profit and for-profit and 8.3 percent for public institutions.

27. For federal corporate tax rate data, see Jack Taylor, "Corporation Income Tax Brackets and Rates, 1909-2002," *SOI Bulletin* (Fall 2003), www.irs.gov/pub/irs-soi/02corate.pdf (accessed September 13, 2011); for state corporate tax rate data, see Tax Foundation, "State Corporate Income Tax Rates 2000-2011," www.taxfoundation.org/taxdata/show/230.html (accessed September 13, 2011).

28. We recognize that part of the investment income generated from endowments is used by not-for-profit institutions to offset business expenses and that amount may be considered nontaxable if the institution were a for-profit school. However, in our calculations we assumed that if the for-profits invest excess cash and that investment (in whatever form it takes) generates investment income of X dollars, then for-profits would be taxed at a rate of 40 percent on this X dollar income. We subsequently applied this same rationale to the way nonprofits generate income from their endowments. Basically, both for-profit and not-for-profit institutions can use their generated returns however they choose, and given that discretion—that is, given their control over what is and is not used to offset operational costs—it would be impossible to state with any certainty what the actual net taxable impact would need to be in either case. We were attempting to demonstrate in our analysis the fundamental differences—taxation—that for-profits are subject to and not-for-profits are not.

29. This and the 10.8 percent corporate tax rate we used are based on data obtained from a large for-profit institution.

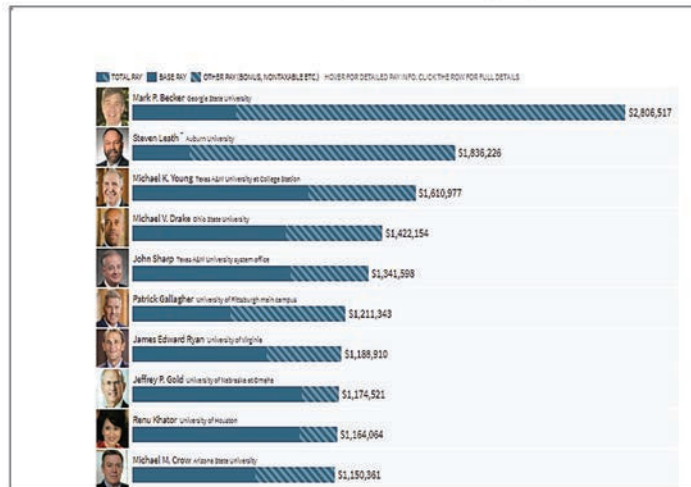
30. Using information shared with us by a large for-profit university, we applied the tax paid by that school as a percentage (10.8 percent) of its revenues to infer the tax on other institutions currently not subject to tax. The lower-than-expected rate in part reflects the fact that some of the revenue ("gross receipts") is offset by deductible expenses. Because other institutions do not have the same profit-making objective, it is impossible to estimate taxes where no profits exist otherwise.

31. We estimated the tax for purchases subject to sales and use taxes (if sales taxes are not assessed, purchasers are still required to pay a use tax). For-profit institutions are required to charge and remit sales tax on revenues in New Mexico and Hawaii, but those are pass-through sales taxes, not what we are seeking to capture here. Because we estimated sales and use taxes as a percentage of revenue, it seems appropriate and expected that 0.5 percent would be significantly lower than actual sales tax paid, which could be in the 8-9 percent range for purchases.

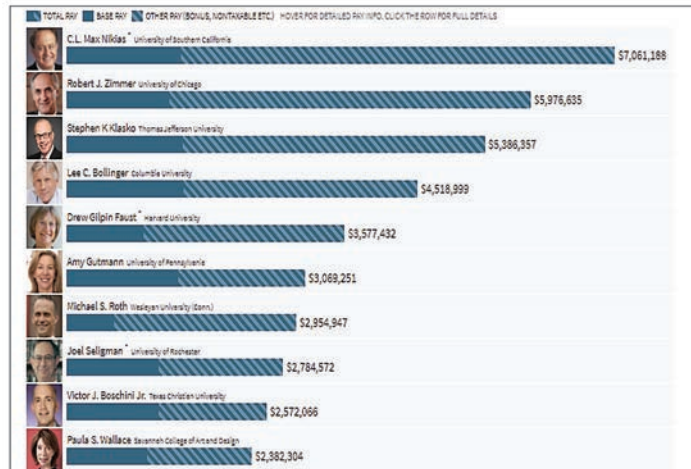
Top 10 Salaries of College Presidents

Source: [Executive Compensation of Public and Private Colleges \(chronicle.com\)](https://www.chronicle.com/article/Executive-Compensation-of-Public-and-Private-Colleges)

Public Colleges and Universities (2019)



Private Colleges and Universities (2018)



Spending By Function

* In the 2017–18 school year, private for-profit colleges spent an average of 27% of their finances on student instruction. For all types of colleges, their breakdown of spending on various functions varied as follows:

Function	Public	Private Nonprofit	Private For-Profit
Instruction[199]	29%	31%	27%
Research[200]	10%	11%	0%
Public service[201]	4%	1%	
Academic support[202]	8%	9%	63%
Student services[203]	6%	8%	
Institutional support[204]	9%	13%	
Auxiliary enterprises[205]	9%	9%	2%
Hospitals[206]	13%	13%	0%
Other[207] [208]	11%	6%	7%

[209] [210]

[209] Table constructed with data from:

a) Dataset: "Table 334.10. Total Expenditures of Public Degree-Granting Postsecondary Institutions, by Purpose and Level of Institution: 2009–10 Through 2017–18." U.S. Department of Education, National Center for Education Statistics, December 2019. <[nces.ed.gov](https://nces.ed.gov/ipeds/data/ipeds_datacenter/data_queries/ipeds_datacenter_queries.asp)>

b) Dataset: "Table 334.30. Total Expenditures of Private Nonprofit Degree-Granting Postsecondary Institutions, by Purpose and Level of Institution: Selected Years, 1999–2000 Through 2017–18." U.S. Department of Education, National Center for Education Statistics, December 2019. <[nces.ed.gov](https://nces.ed.gov/ipeds/data/ipeds_datacenter/data_queries/ipeds_datacenter_queries.asp)>

c) Dataset: "Table 334.50. Total Expenditures of Private For-Profit Degree-Granting Postsecondary Institutions, by Purpose and Level of Institution: Selected Years, 1999–2000 Through 2017–18." U.S. Department of Education, National Center for Education Statistics, December 2019. <[nces.ed.gov](https://nces.ed.gov/ipeds/data/ipeds_datacenter/data_queries/ipeds_datacenter_queries.asp)>

[210] Form: "2018–19 Survey Materials: Finance for Degree-Granting Public Institutions Using GASB [Governmental Accounting Standards Board] Reporting Standards." National Center for Education Statistics, April 2, 2019. <nces.ed.gov>

Page 31 (of PDF):

Part C-1—Expenses and Other Deductions: Functional Classification

This part is intended to collect expenses by function. ...

Include all operating expenses and nonoperating expenses and deductions. ... Included are the costs incurred for salaries and wages, goods, and other services used in the conduct of the institution's operations. Not included is the acquisition cost of capital assets, such as equipment and library books, to the extent the assets are capitalized under the institution's capitalization policy. ...

Operation and maintenance of plant is no longer reported as a separate functional expense category. Instead these expenses are to be distributed among the other functional expense categories.

Page 36 (of PDF):

Glossary ...

Tangible or intangible assets that are capitalized under an institution's capitalization policy; some of these assets are subject to depreciation and some are not. These assets consist of land and land improvements, buildings, building improvements, machinery, equipment, infrastructure, and all other assets that are used in operations and that have initial useful lives extending beyond one year. Capital assets also include collections of works of art and historical treasure and library collections; however under certain conditions such collections may not be capitalized. They also include property acquired under capital leases and intangible assets such as patents, copyrights, trademarks, goodwill, and software. Excluded are assets that are part of endowment funds or other capital fund investments in real estate.

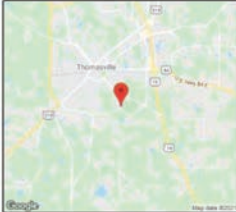
Hyperlink: https://www.justfacts.com/education.asp#_ftn209

Private Non-Profit

Thomas University

Thomasville, GA
651 undergraduate students
thomasu.edu

Year **Private** **Town** **Small**




INSTITUTIONAL HIGHLIGHTS:

Graduation Rate

14%

Salary After Completing

Salary after completing depends on field of study.



Average Annual Cost

Cost includes tuition, living costs, books and supplies, and fees minus the average grants and scholarships for federal financial aid recipients.

\$20,038

FIELDS OF STUDY OFFERED:

Type to search

Explore Field of Study Information

Explore field of study information, such as salary after completing and typical debt. Field of study titles come from National Center for Education Statistics groupings and may not match the exact program titles at Thomas University.

We have information on **23 undergraduate Fields of Study** offered at Thomas University

Public "4-year" HBCU

Harris-Stowe State University

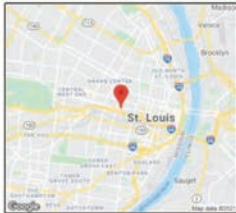
Saint Louis, MO
1,709 undergraduate students
hssu.edu

Year

Public

City

Small



Historically Black College and University

INSTITUTIONAL HIGHLIGHTS:

Graduation Rate ▾

16%

Salary After Completing ▾

Salary after completing depends on field of study.

\$5
\$25,000
\$75,007 \$25,000

Average Annual Cost ▾

Cost includes tuition, living costs, books and supplies, and fees minus the average grants and scholarships for federal financial aid recipients.

\$11,256

FIELDS OF STUDY OFFERED: ▾

Explore Field of Study Information

Explore field of study information, such as salary after completing and typical debt. Field of study titles come from National Center for Education Statistics groupings and may not match the exact program titles at Harris-Stowe State University.

We have information on **25 undergraduate Fields of Study** offered at **Harris-Stowe State University**

Public "2-year" HSI

University of New Mexico-Taos Campus


Ranchos de Taos, NM
616 undergraduate students
taos.unm.edu

2
Year

Public

Rural

Small



Hispanic-Serving Institution

INSTITUTIONAL HIGHLIGHTS:

Graduation Rate

13%

Salary After Completing

Salary after completing depends on field of study.

\$0
\$20,147
\$65,905
\$100,000

Average Annual Cost

Cost includes tuition, living costs, books and supplies, and fees minus the average grants and scholarships for federal financial aid recipients.

\$7,789

FIELDS OF STUDY OFFERED:

Explore Field of Study Information

Explore field of study information, such as salary after completing and typical debt. Field of study titles come from National Center for Education Statistics groupings and may not match the exact program titles at University of New Mexico-Taos Campus.

We have information on **104 undergraduate Fields of Study** offered at **University of New Mexico-Taos Campus**

Table 4. Overall College Completion Rates by Student Characteristics, 2016

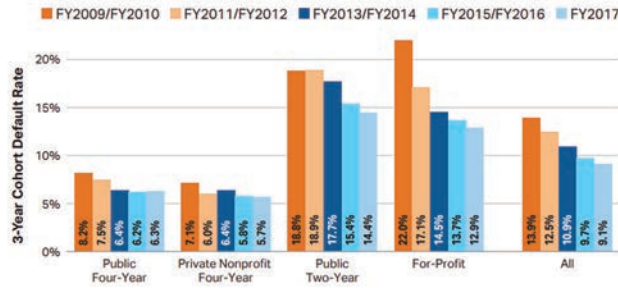
	OVERALL RATE	BY GENDER		BY RACE OR ETHNICITY						
		Men	Women	White	Black	Hispanic or Latino	Asian	Native American	Two or More Races	Unknown Race
Public Four Years	45.3%	42.1%	48.2%	48.2%	36.9%	42.9%	52.8%	45.6%	44.6%	48.6%
Universities	61.3%	57.8%	64.7%	63.0%	51.2%	56.8%	65.7%	51.8%	56.2%	63.3%
Other Four Years	40.3%	37.2%	43.1%	43.5%	32.1%	38.3%	48.0%	42.9%	40.2%	42.9%
Private Four Years	54.4%	52.3%	59.7%	59.1%	46.9%	55.7%	68.3%	70.0%	62.6%	58.1%
Universities	77.8%	76.2%	79.9%	81.3%	69.6%	74.4%	82.1%	79.3%	79.8%	77.5%
Other Four Years	52.7%	50.4%	58.1%	57.4%	44.8%	54.0%	66.8%	68.6%	60.6%	56.0%
For-Profit Four Years	34.3%	35.3%	38.9%	47.1%	38.6%	41.4%	62.6%	57.6%	58.2%	37.1%
Public Two Years	26.0%	25.4%	26.5%	29.4%	17.3%	25.4%	37.1%	36.2%	25.2%	31.2%
Private Two Years	49.6%	50.3%	53.6%	59.8%	45.3%	60.4%	70.2%	62.5%	56.0%	68.2%
For-Profit Two Years	57.7%	56.4%	58.5%	63.1%	50.6%	67.5%	74.9%	71.9%	66.9%	62.1%

Note: "Private" refers to private nonprofit schools. Universities are defined as research or doctoral institutions according to the 2000 Carnegie Classifications. Completion is defined as finishing a formal degree or certificate 150 percent of normal time. Completion is measured for first-time, full-time students seeking a degree or certificate. If an institution reported a completion rate of zero, it is not included in this analysis.

Source: Author's analysis using the Integrated Postsecondary Education Data System from survey year 2016.

Source: "The College Completion Landscape: Trends, Challenges, and Why It Matters" by Bridget Terry Long, 2018.

FIGURE SA-13A Federal Student Loan Three-Year Default Rates by Sector and Separation Cohort, Borrowers Entering Repayment in FY2009 Through FY2017



NOTE: The three-year default rate is defined as the percentage of borrowers in each repayment cohort who default on a federally-held loan within three years of entering repayment. Sector-wide rates are student-weighted, not institution-weighted. Includes degree-granting schools in the United States. Schools are defined as two-year if more than 50% of degrees/certificates awarded are associate degrees or certificates, even if they award some bachelor's degrees.

SOURCE: U.S. Department of Education, College Scorecard data; calculations by the authors.

Hyperlink: <https://research.collegeboard.org/pdf/trends-college-pricing-student-aid-2020.pdf>

Higher Education Has a Tax Problem and It's Hurting Local Communities



An aerial view of the Yale University Campus in New Haven, Connecticut.

Allen Brown—Alamy

IDEAS

BY DAVARIAN L. BALDWIN

APRIL 7, 2021 3:00 PM EDT

Baldwin is the author of *In the Shadow of the Ivory Tower: How Universities Are Plundering Our Cities*

On **March 30, 2020**, toward the beginning of the global COVID-19 pandemic, New Haven citizens stormed the city's Zoom budget meeting to vent their outrage at Yale University's continued strain on city finances. Residents specifically pointed to Yale's vast and tax-exempt property

holdings compared to the deficit-ridden New Haven public schools hungry for property-tax dollars.

Four months later, on July 29, a new coalition of Yale union workers and residents followed up with a 600-vehicle “**Respect Caravan**” that brought downtown traffic to a halt. With signs that read “Yale: Pay Your Fair Share,” organizers acknowledged that the university offers the city voluntary PILOTS (payments in lieu of taxes) but declared these funds were “pocket change” compared to the \$30 billion endowment. For the protestors, COVID-19 merely exacerbated a growing disparity between urban colleges and universities and their host cities.

Universities and their medical centers are registered with the Internal Revenue Service as **501(c)(3)** charitable nonprofit organizations. Because higher education institutions provide the public good of education to surrounding communities, their property holdings are exempt from taxation in all 50 states. But classes with professors and students are a minor side business on college campuses today. The greater value of campuses is their ability to use the nonprofit tax exemption as a tax shelter for profitable research and private investors.

With the meteoric ascendance of the knowledge economy, colleges and universities have become financial titans in urban centers. After a group of universities lobbied to pass the **Bayh Dole Act** in 1980, schools like Stanford, MIT and Yale immediately created technology transfer offices to privatize and profit from federally sponsored research. Today universities use their academic research to create commercial goods or patents in a range of fields, from the pharmaceutical industries and software products to military defense weaponry. After the fall of factories, knowledge has become

the new face of capitalism with university bell towers lauded as the **smokestacks** of today's cities.

Both city leaders and administrators in education rightfully laud the **"economic impact"** that comes from these public-private partnerships facilitated by college campuses. The research makes life-saving discoveries, generates secondary start-up companies and jobs and attracts additional investors in related industries. We can point to the millions in revenue secured by Stanford when university researchers produced **Google** or the financial rebound generated for **Pittsburgh** when Silicon Valley companies and local universities helped revive it as a tech city.

Today's schools bring the once suburban research parks to the city as "innovation districts" where academic research and corporate partnerships meet real estate, retail and cheap labor. Real estate developers like **Wexford: Science + Technology** focus on what they call "knowledge communities" and work with cities and schools to build a monied portfolio of university-affiliated projects like Philadelphia's uCity Square, Converge Miami and Cortex in St. Louis. Urban neighborhoods are being transformed to optimize "value capture": the conversion of city blocks into research profits. Under the cover of educational purposes, research that has the potential to produce millions in patents and revenues remains largely tax exempt while conducted in tax-exempt buildings. These financial arrangements are quite lucrative for city leaders, university administrators and their corporate partners.

But what about city residents, especially those who live in the neighborhoods surrounding the schools? A critical paradox has emerged with dire consequences for our cities. We assume that higher education is an inherent public good, most clearly marked by its exemption from property

taxes. But nonprofit status is precisely what allows for an easier transfer of public dollars into higher education's private developments. The former mayor of New Haven, Conn., Toni Harp, said such arrangements create a property-tax gray area where profitable research produced for private companies is conducted in educational buildings that are not on the tax rolls. (In 2010, the [Lincoln Institute of Land Policy](#) outlined the increased number of schools starting to pay PILOTs.) At approximately \$13 million, Yale pays the largest PILOT in the country. But this is merely a [fraction](#) of the estimated \$102 million in property taxes that, if Yale weren't tax exempt, would come from the school or the additional \$31 million that would come from Yale-New Haven Hospital.

Most schools also reap the benefits of police and fire protection, snow and trash removal, the maintenance of roads and the electrical grid, and other municipal services while struggling host cities pay the price. Homeowners and small-business owners ultimately carry the weight of increased property taxes caused by campuses and their knowledge communities while the owners of rental properties make units smaller and inflate their prices to prioritize the needs and financial means of those affiliated with the university.

In 2016, [Princeton University](#) paid more than \$18 million to settle a lawsuit with residents of the historically Black neighborhood of Witherspoon-Jackson. Residents discovered a noticeable jump in their property-tax bill and wondered why. They realized that nearby university buildings remained tax-exempt while producing research that generated millions of dollars in commercial royalties. One plaintiff in the Princeton case described the university as a "[hedge fund that conducts classes.](#)"

And if one thinks this tax hustle is simply an elite, private-school problem, let's turn to Arizona State University. In 2018, with a six to one **vote**, the Tempe City Council approved an Omni Hotel and Conference Center project that would pay almost no sales tax for up to 30 years. It would also pay no property taxes because it is going to sit on university land owned by the Arizona Board of Regents. Meanwhile, as in many states, Arizona continued to pull back on its **contributions** to public higher education.

ASU President Michael Crow, a self-proclaimed "academic entrepreneur," was unabashed about looking for new revenue streams: "Our funding is down 60% per student per year, O.K.," **he said in a 2018 interview**. "Fine, then we come up with other revenue sources to advance the university including using property that has been given to us." ASU realized they could lease their tax-exempt land to private companies, and instead of shelling out property taxes, these companies could make a lower direct payment to the university. Elected officials have no say in how the money is spent while such university developments simultaneously raise property values and contribute little to public services.

Sean McCarthy, a research analyst with the Arizona Tax Research Association, held little sympathy for ASU's stated plight of balancing the budget. After reading about the Omni deal, he put together a scathing policy review detailing the long history of "**tax free zones**" at ASU. He points to the State Farm Insurance regional headquarters on campus as an example of how this works: The Arizona Board of Regents holds the deed to the land and State Farm leases the property, which allows the largest commercial development in Arizona to pay a fraction of its property-tax burden. ASU is able to use the revenue to spend without public oversight.

Arizona Attorney General Mark Brnovich shared McCarthy's outrage, and in January 2019 he **sued** the Arizona Board of Regents for essentially renting out its tax-exempt status to private businesses. Few were surprised when the State Supreme Court **dismissed** the case in developer-friendly Arizona. And ASU continues to expand its campus projects into downtown Phoenix where they have partnered with Wexford to build an "innovation center." I spoke with Rick Naimark, ASU's associate vice president for program development planning, and he told me ASU expects that the designation of "education purposes" will also exempt this development from property taxes.

But the twin forces of racial injustice and the pandemic placed a new spotlight on the economic impact of higher education. The same week as New Haven's "Respect Caravan," more than **100 students** and Philadelphia residents gathered to protest the actions of the University of Pennsylvania's police department while calling for a PILOT to support the deteriorating public schools. In **November 2020**, the university announced its contribution of a \$100 million "charitable gift" over a 10-year period, largely targeted for asbestos removal in public school buildings. All parties celebrated this decision, but many also **noted** the careful legal language of "gift." The financial distinction of gift, compared to payment, absolves the university from any long-term responsibility or acknowledgment that the wealth of their \$14.9 billion endowment is directly connected to the city's budget woes.

Such piecemeal victories have not deterred increased calls for a new tax arrangement between urban universities and their cities. Campaigns from the **University of Chicago** to **UCLA** are seizing the moment to argue that a key piece of social justice and anti-racism requires that schools develop a new business model that, at least, redistributes the wealth extracted from

cities back into its neighborhoods. If higher education is going to be celebrated as the new economic engine, its prosperity cannot come at the cost of our city's most vulnerable residents.

[Additional submission by Ms. Adams follow:]



National Association of
Independent Colleges and
Universities

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Washington, DC 20036-5405

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April 16, 2021

The Honorable Robert "Bobby" Scott
Chairman
House Committee on Education and Labor
2176 Rayburn HOB
Washington, DC 20515

The Honorable Virginia Foxx
Ranking Minority Member
House Committee on Education and Labor
2101 Rayburn HOB
Washington, DC 20515

Dear Chairman Scott and Ranking Member Foxx:

On behalf of the National Association of Independent Colleges and Universities (NAICU), I am submitting this letter for the record in conjunction with the April 20, 2021, Full Committee hearing on the for-profit conversions of colleges seeking nonprofit status.

NAICU serves as the unified voice of private, nonprofit higher education. Founded in 1976, NAICU is the only national organization solely focused on representing private, nonprofit higher education on public policy issues in Washington, DC. NAICU's membership reflects the diversity of private, nonprofit higher education in the U. S. Our member institutions include major research universities, faith-based colleges, Historically Black Colleges and Universities, Minority-Serving Institutions and Tribal Colleges, art and design colleges, traditional liberal arts and science institutions, women's colleges, work colleges, two-year colleges, and schools of law, medicine, engineering, business, and other professions. With more than 5 million students attending 1,700 independent colleges and universities in all 50 states, and more than 1 million employees, the private sector of American higher education has a dramatic impact on our nation's larger public interests.

The formation of the first nonprofits over a century ago reflected the unique American tendency to create voluntary associations to meet important public needs. With the exception of the 2017 tax levied on certain nonprofit private colleges endowments and net investment earnings, this tradition has since been upheld by laws granting an exemption from federal income tax to nonprofit organizations that dedicate its resources not to individuals or individual profit but to community public service. The U.S. has a unique blending of independent nonprofit and governmental providers in important service areas, such as higher education, hospitals, and other human services.

NAICU supports and believes in the role of the federal government to provide appropriate oversight of U.S. nonprofits and charitable organizations as a whole. If any organization wants to be established as a nonprofit, it must comply with a set of rules and follow a uniform approval process applicable to all. This would certainly include for-profit entities that want to transition to nonprofit status. We are proud of the non-profit tradition in American higher education, and believe it has contributed enormously to our very essence as a nation. For these reasons, we would welcome the conversions of for-profit institutions to nonprofit status, as long as it is with the intent to function as a true nonprofit, serving students and the surrounding communities.



Page 2

Nonprofit status should not be abused or used as a cover for any group to make profits, self-deal, or otherwise violate existing nonprofit laws.

As this committee and the U.S. Departments of Education and Treasury examine ways to strengthen federal oversight of for-profit conversions, we hope you will keep in mind the characteristics that make our nation's non-profit institutions unique, and exercise oversight that encourages new non-profit entities to function effectively while also allowing them the freedom to serve their students in new and unique ways appropriate to their self-defined missions.

We look forward to working with you and the committee staff as this process moves forward, especially as potential legislation is crafted. Please feel free to continue to use NAICU as a resource. We appreciate your partnership on the many important issues facing our institutions and the students and communities we serve.

Sincerely,

A handwritten signature in cursive script that reads 'Barbara K. Mistick'.

Barbara K. Mistick
President

[Questions submitted for the record and the responses by Ms. Cao follow:]

MAJORITY MEMBERS:
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 EDUCATION AND LABOR
 U.S. HOUSE OF REPRESENTATIVES
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 WASHINGTON, DC 20515-6100

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 VIGANCY

April 28, 2021

Ms. Yan Cao, J.D.
 Fellow
 The Century Foundation
 625 Caton Avenue, Apartment 4E
 Brooklyn, NY 11218

Dear Ms. Cao,

I would like to thank you for testifying at the April 20, 2021 Committee on Education and Labor hearing entitled "*For-Profit College Conversions: Examining Ways to Improve Accountability and Prevent Fraud.*"

Please find enclosed additional questions submitted by Committee members following the hearing. Please provide a written response no later than Wednesday, May 5, 2021, for inclusion in the official hearing record. Your responses should be sent to Mariah Mowbray and Ben Sinoff of the Committee staff. They can be contacted at 202-225-3725 should you have any questions.

I appreciate your time and continued contribution to the work of the Committee.

Sincerely,

ROBERT C. "BOBBY" SCOTT
 Chairman

Enclosure

Committee on Education and Labor Hearing
 "For-Profit College Conversions: Examining Ways to Improve Accountability and Prevent Fraud"
 Tuesday, April 20, 2021
 10:15 a.m. (Eastern Time)

Chairman Robert C. "Bobby" Scott (D - VA)

- 1) Ms. Cao, on the topic Keiser University, am I correct in understanding that its president and former owner currently chair's Education's accreditation oversight body. Do you have concerns about this role?
 - a. Does it pose any risk to that body's ability to accurately assess what role accreditors should play with respect to overseeing for-profit college conversions?

Committee on Education and Labor Hearing

“For-Profit College Conversions: Examining Ways to Improve Accountability and Prevent Fraud”

**Tuesday, April 20, 2021
10:15 a.m. (Eastern Time)**

Chairman Robert C. “Bobby” Scott (D – VA)

Questions for the Record:

- 1) *Ms. Cao, on the topic Keiser University, am I correct in understanding that its president and former owner currently chairs Education’s accreditation oversight body. Do you have concerns about this role?*
- a) Does it pose any risk to that body’s ability to accurately assess what role accreditors should play with respect to overseeing for-profit college conversions?*

Response:

Federally recognized accreditors must review structural changes—including conversions from for-profit to nonprofit status—and are granted authority to establish their own approval criteria, within certain parameters.¹ Accreditors must also establish criteria for identifying institutional changes that trigger either a structural change review or a “new comprehensive evaluation” that mirrors the initial accreditation review process.² Accreditation is not an asset that can be bought and sold,³ and accreditors are tasked with safeguarding the integrity of accreditation from corporate gamesmanship and regulatory arbitrage.

As the entity tasked with oversight of federally recognized accreditors, the National Advisory Committee on Institutional Quality and Integrity (NACIQI) is uniquely positioned to address the risks posed by for-profit conversions, and to ensure that accreditors properly review proposed conversions to minimize risk of student harm and abuse of Title IV funds.

¹ See 34 CFR 602.22 (requiring accreditor policies to ensure that “high-impact, high-risk changes,” including “[a]ny change in the legal status, form of control, or ownership of the institution,” will not “adversely affect the capacity of the institution to continue to meet the agency’s standard”).

² 34 CFR 602.22(h) (“The agency’s substantive change policy must define when the changes made or proposed by an institution are or would be sufficiently extensive to require the agency to conduct a new comprehensive evaluation of that institution.”).

³ See 11 U.S.C. § 541(b)(3) (excluding Title IV eligibility, accreditation and state licensure from institutional assets that are protected under bankruptcy law).

In January 2018, as the conversion efforts of Dream Center Foundation and Grand Canyon Education came to light, five Senators wrote to NACIQI's Chair, Dr. Art Keiser, and Vice Chair, Mr. Frank Wu, urging NACIQI to recommend "guidelines and practices" for accreditors' review of conversions, and to scrutinize accreditors' track records on conversions when assessing accreditors' performance.⁴

The same senators also asked Dr. Keiser to recuse himself because of his role as Chancellor and CEO of Keiser University, a for-profit college which had converted to nonprofit status.⁵ Dr. Keiser personally financially benefited from lax oversight of conversions: after telling IRS that his family would not derive "any non-incidental private benefit" from the nonprofit, Keiser and his family received over \$34 million in payments from the post-conversion enterprise in a single tax year (2011).

Federal law limits public officials from investigating, rendering advice, or making recommendations in matters where the official, his family, or a closely affiliated organization has a financial interest.⁶

However, as NACIQI received testimony on the risks associated with conversions, Dr. Keiser presided over the hearing. When, in the aftermath of Dream Center's March 2019 collapse, a NACIQI member moved for NACIQI to take further action, including the development of best practices for accreditors, Dr. Keiser expressed disinterest: "I'm not sure what would be your purpose."⁷ Ultimately NACIQI failed to take any meaningful action to protect students from the risks associated with for-profit college conversions.

Had NACIQI taken a proactive stance on conversions (as urged by lawmakers), Dream Center's March 2019 collapse may have been avoided or its harms mitigated.

Instead, under Dr. Keiser's leadership, NACIQI took steps toward penalizing an accreditor, the Higher Learning Commission (HLC), which had withdrawn accreditation from two Art Institutes campuses following a close review of Dream Center's conversion transactions.

⁴ Feb. 11, 2018 Letter to NACIQI, available at <https://sites.ed.gov/naciqi/files/2018/03/2018.01.11-Letter-to-NACIQI-re-sectorial-conversions.pdf>.

⁵ See generally, *Some Owners of Private Colleges Turn a Tidy Profit by Going Nonprofit*, Patricia Cohen, *The New York Times*, March 2, 2015; "Keiser: Not-for-profit but still lucrative," Michael Vasquez, *Miami Herald*, April 23, 2015; "The Covert For-Profit: How College Owners Escape Oversight through a Regulatory Blind Spot," The Century Foundation, September 22, 2015; "Should This College Operator Run A Key Federal Oversight Panel?" David Halperin, *The Republic Report*, June 19, 2017; "How For-Profits Masquerade as Nonprofit Colleges," The Century Foundation, October 7, 2020.

⁶ 18 U.S.C. § 541(a)

⁷ NACIQI meeting transcript, July 30, 2019, p. 239-240, available at <https://sites.ed.gov/naciqi/files/2019/08/0730DED-OPE.pdf>.

While Dr. Keiser stated in 2018 that he had consulted with NACIQI counsel and determined that his recusal was unnecessary,⁸ those communications have never been made public.

It is also unclear whether those ethics opinions were reviewed in light of the Keiser family's ongoing effort, from at least 2018 to the present, to amass control over nonprofit Webber International University and Webber affiliate St. Andrews University ("Webber-St. Andrews"). Recent reports indicate overlapping leadership between Webber-St. Andrews and Keiser University⁹ as well as shared real estate between Webber-St. Andrews and a private, for-profit college held by the Keiser family.¹⁰

Based on statements that a senior Keiser University official began to revise academic programs at Webber-St. Andrews programs in 2018,¹¹ the duration of NACIQI's engagement with accreditor oversight of conversions has overlapped with the Keiser family's process of asserting control over a nonprofit that appears to be engaged in insider dealings.

Webber's certification of eligibility for federal aid expires June 30, 2021¹² and close scrutiny from its accreditor, The Southern Association of Colleges and Schools Commission on Colleges (SACSCOC), about a change in control would complicate renewal. Per Department of Education data, Webber has not submitted an application for change in control review. Nor has NACIQI established standards or best practices on how accreditors should identify and review changes in control and nonprofit status.

⁸ NACIQI meeting transcript, May 24, 2018, p. 14-15, available at <https://sites.ed.gov/naciqi/files/2018/06/052418NACIQI-Bookmarks1.pdf>.

⁹ In 2020, Dr. Bernhardt, who held a position as Associate Vice Chancellor Regional Operations at Keiser University was elevated to Interim Campus President of St. Andrews. St. Andrews Univ. Press Release: "DR. ELLEN BERNHARDT APPOINTED INTERIM CAMPUS PRESIDENT," June 11, 2020, <https://www.sa.edu/dr-ellen-bernhardt-named-interim-president/>.

¹⁰ "Is Arthur Keiser in Charge at St. Andrews University?," David Halperin, The Republic Report, last updated Feb. 22, 2021.

¹¹ In 2018, Dr. Ellen Bernhardt began "to develop and implement special projects to support the growth" of St. Andrews while pursuing a doctoral degree from Keiser University in Business Administration with a "Specialization in Marketing." See "DR. ELLEN BERNHARDT APPOINTED INTERIM CAMPUS PRESIDENT," *see also* [LinkedIn: Dr. Ellen Bernhardt](#), accessed May 3, 2020.

¹² Department of Education: [PEPS Data Extracts, School File](#) (April 2021).

[Questions submitted for the record and the responses by Mr. Gillen follow:]

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April 28, 2021

Andrew Gillen, Ph.D.
 Senior Policy Analyst
 Texas Public Policy Foundation
 901 Congress Avenue
 Austin, TX 78701

Dear Dr. Gillen,

I would like to thank you for testifying at the April 20, 2021 Committee on Education and Labor hearing entitled "*For-Profit College Conversions: Examining Ways to Improve Accountability and Prevent Fraud.*"

Please find enclosed additional questions submitted by Committee members following the hearing. Please provide a written response no later than Wednesday, May 5, 2021, for inclusion in the official hearing record. Your responses should be sent to Mariah Mowbray and Ben Sinoff of the Committee staff. They can be contacted at 202-225-3725 should you have any questions.

I appreciate your time and continued contribution to the work of the Committee.

Sincerely,

ROBERT C. "BOBBY" SCOTT
 Chairman

Enclosure

Committee on Education and Labor Hearing
 "For-Profit College Conversions: Examining Ways to Improve Accountability and Prevent Fraud"
 Tuesday, April 20, 2021
 10:15 a.m. (Eastern Time)

Representative Scott Fitzgerald (R – WI)

1. Dr. Gillen, the number one priority of educational institutions should be serving students. In that vein, what has your research shown about student success at all institutions regardless of tax status? How can Congress improve our accountability framework to give students a better chance of success no matter where they choose to go to school?
2. Dr. Gillen, there are more important issues facing postsecondary education than the tax status of an institution. There are assaults on First Amendment rights, chronic student under-preparedness for the workforce, and skyrocketing tuition prices. How could improved accountability metrics help address these problems that Americans really care about?

Representative Diana Harshbarger (R – TN)

1. Have there been any studies about the local community impact of for-profit colleges? If so, what has the outcome been?



Follow-Up Responses to Questions from the House Committee on Education and Labor
On For-Profit College Conversions
Andrew Gillen, Ph.D.
5/4/2021

Chairman Scott, Ranking Member Foxx, and esteemed members of the committee, thank you for your questions following the recent hearing on for-profit college conversions.

Representative Scott Fitzgerald (R – WI)

1. Dr. Gillen, the number one priority of educational institutions should be serving students. In that vein, what has your research shown about student success at all institutions regardless of tax status? How can Congress improve our accountability framework to give students a better chance of success no matter where they choose to go to school?

My research shows that there are high-performing and low-performing colleges among all types of colleges. For example, while the Gainful Employment regulations were primarily targeted at for-profit colleges, Dr. Richard Vedder and I estimated that if they were applied to all colleges, only 28% of students who graduated from a failing program attended a for-profit college (see [Obama Did Persecute For-Profit Colleges](#) in *The Wall Street Journal* for more details). In other words, only applying an accountability metric to for-profit universities would miss 72% students whose programs are burdening them with excessive student loan debt. Those students aren't any less burdened by excessive student loan debt just because their college was a public or private nonprofit.

Since tax-status is such a poor proxy for program quality, I recommend that any new or revived accountability metric be applied to colleges of all types, rather than selectively applied based on tax-status.

2. Dr. Gillen, there are more important issues facing postsecondary education than the tax status of an institution. There are assaults on First Amendment rights, chronic student under-preparedness for the workforce, and skyrocketing tuition prices. How could improved accountability metrics help address these problems that Americans really care about?

Representative Fitzgerald, you are absolutely right about the many troubling trends on American campuses today. However, I remain guardedly optimistic about the future because I think that accountability will drastically improve higher education. There are two parallel accountability tsunamis that are bearing down on higher education (see [Two Tsunamis are About to Hit Higher Education](#) in *Real Clear Education* for more details).

The first is consumer driven accountability, which is driven by the higher quality and quantity of data and information. Until recently, students made enrollment decisions essentially blindfolded, knowing little about the outcomes of recent graduates. But with the new U.S. Department of Education College Scorecard data, this is changing. Students can now see the student loan debt and earnings of recent graduates. This data will allow students to make much more informed decisions, and as

students vote with their feet and wallets, successful programs will see increased demand and programs that leave students with unaffordable debt will wither.

The second accountability tsunami will be driven by federal and state governments. Both provide massive subsidies to higher education, and the new data will expose the need for both the federal and state governments to introduce new accountability mechanisms to ensure that taxpayers are getting a good return on their investment.

Both of these accountability tsunamis will help shift higher education to be more focused on student needs, a healthy change from the status quo under which colleges can largely pursue their own interests at taxpayer expense.

Representative Diana Harshbarger (R – TN)

1. Have there been any studies about the local community impact of for-profit colleges? If so, what has the outcome been?

Colleges affect the local economy in two main ways. First, they can relocate spending, as students and faculty that would have lived and spent their money elsewhere instead live and spend in the community where the college is located. While a benefit for the college's community, this type of benefit is zero-sum, it merely reallocates the economic pie as other communities are losing the spending of students and faculty. Second, education can improve the productive capacity of many students. If some graduates that stay in the local community, their increased productivity should boost the local economy. This type of benefit grows the size of the economic pie.

How big are these benefits? I'm not familiar with any empirical studies that have examined the local impact of for-profit colleges.

Theoretically, I would hypothesize that a for-profit college's impact on the local economy would be quite similar to community colleges. Students at both types of college are more likely to already be employed, or to have families, or to be commuter students, all of which make it more likely that students will stay in the local area after graduating.

Thank you again for the opportunity to discuss these important issues with you. If you have any further questions, please don't hesitate to reach out.

Andrew Gillen

[Questions submitted for the record and the responses by Ms. Emrey-Arras follow:]

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April 28, 2021

Ms. Melissa Emrey-Arras
 Director, Education, Workforce and Income Security
 Government Accountability Office
 10 Causeway Street, Room 575
 Boston, MA 02222

Dear Ms. Emrey-Arras,

I would like to thank you for testifying at the April 20, 2021 Committee on Education and Labor hearing entitled "*For-Profit College Conversions: Examining Ways to Improve Accountability and Prevent Fraud.*"

Please find enclosed additional questions submitted by Committee members following the hearing. Please provide a written response no later than Wednesday, May 5, 2021, for inclusion in the official hearing record. Your responses should be sent to Mariah Mowbray and Ben Sinoff of the Committee staff. They can be contacted at 202-225-3725 should you have any questions.

I appreciate your time and continued contribution to the work of the Committee.

Sincerely,

ROBERT C. "BOBBY" SCOTT
 Chairman

Enclosure

Committee on Education and Labor Hearing
"For-Profit College Conversions: Examining Ways to Improve Accountability and Prevent Fraud"
 Tuesday, April 20, 2021
 10:15 a.m. (Eastern Time)

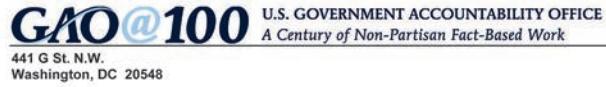
Ranking Member Virginia Foxx (R – NC)

Ms. Emrey-Arras, I would like you to differentiate facts regarding GAO's findings from extrapolations members of Congress are construing from your report. Therefore, I would like one aspect of the hearing clarified for the record.

Representative Alma Adams (D-NC) asked you during the hearing what it meant in terms of protecting the best interests of students when newly created nonprofits acquired formerly for-profit colleges.

I have two questions for you:

1. Did the GAO examine student outcomes as part of your report on for-profit to non-profit conversions?
2. Did your response to Representative Adams represent the views of GAO based on the report you conducted, or was your response your personal judgement about students' educational experience?



May 4, 2021

The Honorable Robert "Bobby" Scott
Chairman
Committee on Education and Labor
House of Representatives

Subject: Responses to Questions for the Record; Hearing Entitled "For-Profit College
Conversions: Examining Ways to Improve Accountability and Prevent Fraud"

Dear Chairman Scott,

Enclosed please find GAO's response to your questions regarding my testimony on for-profit
college conversions before the House Committee on Education and Labor on April 20, 2021.

If you have any questions about the responses to your questions or need additional information,
please contact me at (617) 788-0534 or emreyarrasm@gao.gov.

Sincerely yours,

A handwritten signature in cursive script that reads "Melissa Emrey-Arras".

Melissa Emrey-Arras
Director, Education, Workforce and
Income Security Issues

Enclosure

Questions for the Record for Ms. Melissa Emrey-Arras
House Committee on Education and Labor
Full Committee Hearing on April 20, 2021
For-Profit College Conversions: Examining Ways to Improve Accountability and Prevent Fraud

The Honorable Virginia Foxx

Ms. Emrey-Arras, I would like you to differentiate facts regarding GAO's findings from extrapolations members of Congress are construing from your report. Therefore, I would like one aspect of the hearing clarified for the record.

Representative Alma Adams (D-NC) asked you during the hearing what it meant in terms of protecting the best interests of students when newly created nonprofits acquired formerly for-profit colleges.

I have two questions for you:

1. Did the GAO examine student outcomes as part of your report on for-profit to non-profit conversions?

GAO did not examine student outcomes as a part of its report on for-profit college conversions.

2. Did your response to Representative Adams represent the views of GAO based on the report you conducted, or was your response your personal judgement about students' educational experience?

My response to Representative Adams included facts from our report about the types of nonprofit organizations that acquired the 59 colleges in our review, including the number of conversions in which the nonprofit purchaser was an existing nonprofit college (5 of 59) and the number of conversions in which the nonprofit purchaser was new and had no prior activities, having been created specifically to purchase the college (9 of 59).

I also remarked upon the different educational experience brought to bear when an existing nonprofit college takes over the operations of a for-profit college vs. a nonprofit organization that lacks prior experience operating a college, such as a foundation or scholarship fund. My response referred to the operational experience of such nonprofit purchasers rather than the educational experience of students. It did not reflect personal judgment about student experiences.

[Whereupon, at 1:56 p.m., the committee was adjourned.]

