

Background

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Data Sharing Can Reduce Fraud in the Pell Grant Program

Kirk A. Johnson, Ph.D.

Next year's Higher Education Act reauthorization and other recently introduced legislation provide Congress and the Bush Administration with an excellent opportunity to cut waste and fraud in the U.S. Department of Education's Pell Grant program. By changing how financial information is verified, Congress could save between \$300 million and \$600 million per year at a time when the Pell Grant program is becoming increasingly expensive to operate.

Curtailing waste and fraud is of special importance to the 108th Congress, as the 2004 Congressional Budget Resolution mandates that each congressional committee cut 1 percent of its discretionary budget items by eliminating waste.¹ One proposal—the Student Aid Streamlined Disclosure Act of 2003 (H.R. 3613), introduced by Representative Sam Johnson (R-TX)—would accomplish this by using data sharing to reduce fraud and waste in the Pell Grant program.

Reducing fraud and waste in the Pell grant program would yield substantial budgetary savings:

Reduced fraud. A recent U.S. General Accounting Office (GAO) report found that fraud accounted for more than \$600 million in Pell Grants from fiscal year (FY) 2001 to FY 2002, or just over 3 percent of the program dollars per year.² Eliminating this fraud

1. See Brian M. Reidl, "How Congress Can Achieve Savings of 1 Percent by Targeting Waste, Fraud, and Abuse," Heritage Foundation *Background* No. 1681, August 28, 2003, at www.heritage.org/research/budget/bg1681.cfm.

Talking Points

- Pell Grant fraud costs about \$300 million per year—enough money to give \$4,000 Pell Grants to 75,000 needy college students every year.
- Allowing the IRS to verify information that student aid applicants provide to the U.S. Department of Education would reduce fraud, streamline program administration, and reduce the burden on the applicants. This would yield estimated savings of \$300 million to \$600 million per year.
- The Student Aid Streamlined Disclosure Act of 2003 (H.R. 3613), recently introduced by Representative Sam Johnson (R-TX), would amend the Internal Revenue Code of 1986 to allow this kind of data sharing.

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(202) 546-4400 heritage.org

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would free roughly \$300 million per year for grants to low-income college students—enough money to fund \$4,000 Pell Grants to 75,000 needy students who might otherwise be turned away.

Reduced waste. The Office of Management and Budget estimates that if the Internal Revenue Service (IRS) and the Department of Education shared and verified income information of student aid applicants, total savings (both in terms of fraud and in terms of program administration) might be as high as \$638 million per year.³

What Is the Pell Grant Program?

The Pell Grant program is the largest federal aid program for postsecondary students, with a budget of nearly \$11.4 billion for FY 2003 (representing almost half of all federal postsecondary aid administered by the Department of Education).⁴ Pell Grants are awarded to undergraduate students according to a need-based formula established by Congress,⁵ which uses the student's and (usually) the parents' incomes and assets to gauge eligibility.

To apply, students must fill out a Free Application for Federal Student Aid (FAFSA), which asks for income and asset information. From this information, the Department of Education calculates the expected family contribution (EFC) toward the student's college expenses, which is a portion of family income and assets. The poorest undergraduate students have an EFC of \$0, which generally qualifies

them for the maximum Pell Grant of \$4,050 for the 2003–2004 academic year. Smaller Pell Grant awards are made until the EFC rises above \$3,850, at which point a student is ineligible.

As a verification measure, about 30 percent of students who apply for federal student aid each year are required to provide tax returns or other documents to their school to substantiate the income reported on their FAFSA form.⁶ If there is a large discrepancy between tax documents and the FAFSA (generally over \$400), the FAFSA information is corrected to match the tax return and the EFC is recalculated. Students who refuse to provide tax documents are denied federal student aid.

The Extent of Pell Grant Fraud

There are two basic problems with the existing system. First, there is a fairly high incentive to cheat the system. At the same time, students can misrepresent their income (or their parents' income) on the FAFSA with only a small chance of discovery. The Department of Justice and the Department of Education's Office of the Inspector General are understandably far more likely to pursue and prosecute large cases of student aid abuse rather than individual ones.

In March 2001, for example, the Inspector General's office charged 18 parents and eight financial aid advisers with fraudulently obtaining \$2.6 million in student grants and loans.⁷ More than half of

2. U.S. General Accounting Office, *Taxpayer Information: Increased Sharing and Verifying of Information Could Improve Education's Award Decisions*, GAO-03-821, July 2003, at www.gao.gov/new.items/d03821.pdf.
3. Office of Management and Budget, "Department of Education," in *Budget of the U.S. Government, Fiscal Year 2004* (Washington, D.C.: U.S. Government Printing Office, 2003), p. 98, at www.whitehouse.gov/omb/budget/fy2004/pdf/budget/education.pdf.
4. U.S. Department of Education, "Education Department Budget by Major Program," updated March 5, 2003, at www.ed.gov/about/overview/budget/history/edhistory.pdf (November 4, 2003).
5. Under very limited circumstances, such as certain post-baccalaureate teacher licensure programs that do not culminate in graduate degrees, Pell Grants are available to graduate students. In the vast majority of cases, however, they are awarded only to undergraduates. For more information, see U.S. Department of Education, "Chapter 1: Student Eligibility," in *2003-04 Federal Student Aid Handbook: Federal Pell Grant Program*, Vol. 3, 2003, at ifap.ed.gov/sfahandbooks/attachments/0304Vol3Ch1.pdf.
6. According to the GAO, the Department of Education has verified the income and other information of about 30 percent of postsecondary aid applicants in every year since the mid-1980s. The department focuses on those applicants who, based on past experience, are the most likely to submit applications with errors or may be eligible for grants rather than just loans.
7. For more on this case, see Office of Management and Budget, "Department of Education," in *Budget of the U.S. Government: Fiscal Year 2003* (Washington, D.C.: U.S. Government Printing Office, 2002), p. 113, at w3.access.gpo.gov/usbudget/fy2003/pdf/bud13.pdf, and press release, "Financial Aid 'Preparers' and Parents Among 26 Charged in Separate Cases Alleging \$2.6 Million in Student Aid Fraud," U.S. Department of Education, Office of Inspector General, March 16, 2001, at www.ed.gov/about/offices/list/oig/invtreports/chi32001.html.

the alleged fraud (about \$1.4 million) centered on a single financial aid consultant. Many of the indicted parents continued to file accurate tax returns to the IRS while reporting lower incomes to the Department of Education. Many other such large-scale cases have been filed over the past few years.

The second problem is verification. Even if the student is one of the 30 percent who must verify income, these tax returns come directly from the student, not the IRS, so the actual documents could easily be altered or made up out of whole cloth.⁸ In the fraud case cited above, the financial adviser allegedly manufactured false tax returns in the event that one or more of the applications submitted were chosen for verification.

Although large-amount cases such as this one attract significant attention from federal prosecutors and the media, individual student small-dollar fraud/overpayments have not been adequately quantified until recently. In July 2003, the GAO reported the results of a Department of Education statistical project designed to estimate how many dollars in Pell Grants are awarded to ineligible students.⁹ It found that the Department of Education had made \$602 million in Pell Grant overpayments between FY 2001 and FY 2002 (\$272 million in FY 2001 and \$330 million in FY 2002), representing about 3.3 percent of the program funds allocated for grants. Curtailing this fraud would effectively increase the amount of money available for needy college students by roughly \$300 million per year—enough to fund \$4,000 Pell Grants to 75,000 needy students.

According to the Office of Management and Budget, data sharing to reduce fraud and administrative costs could save \$638 million per year.¹⁰ The Con-

gressional Budget Office estimates potential savings of \$2.4 billion over 10 years, or \$240 million per year,¹¹ and the House Committee on Education and the Workforce estimates potential savings of \$340 million.¹² Total savings from data sharing, from both reduced fraud and reduced administrative waste, could reasonably be expected fall in the range of \$300 million to \$600 million per year.

Possible Solutions for Curbing Fraud

The Bush Administration, the GAO, and other agencies have suggested that data sharing between the Department of Education and the IRS could curb Pell Grant and other student aid abuse, saving taxpayers' money in the process. In November 2003, Representative Johnson introduced the Student Aid Streamlined Disclosure Act of 2003 (H.R. 3613), which would amend Section 6103 of the Internal Revenue Code of 1986, authorizing the IRS to share limited taxpayer information with the Department of Education for the narrow purpose of verifying student eligibility for financial aid.

Such data sharing could work in one of two ways. Under the first option, a student (and his or her parents) would sign a release authorizing the IRS to release the tax information to the Department of Education. The student would then not have to provide the tax return information; instead, the IRS would automatically forward the information to the Department of Education, thus lessening the applicant's burden while also reducing administrative costs.

The drawback is that under the current system, a student can apply for student aid as early as the January prior to the academic year for which aid is sought. The IRS typically will not process the returns and have them ready until months later.

8. Instead of providing tax returns, students can sign a statement indicating that they (and their parents, if applicable) did not earn enough money to require filing tax returns.

9. U.S. General Accounting Office, *Taxpayer Information: Increased Sharing and Verifying of Information Could Improve Education's Award Decisions*.

10. Office of Management and Budget, "Department of Education," in *Budget of the U.S. Government, Fiscal Year 2004*, p. 98.

11. Congressional Budget Office, "An Evaluation of the Budgetary Impact of House Committee Suggestions Submitted for the House Budget Committee Print: *Addressing Government Waste, Fraud, and Abuse*," November 12, 2003, p. 3, at www.cbo.gov/showdoc.cfm?index=4734&sequence=0. The CBO analysis is unclear on this point, but the cost savings estimate appears to take into consideration only the fraud reduction aspects of the proposal.

12. Press release, "House Republicans Introduce Bill to Protect Disadvantaged Students & Taxpayers Against Pell Grant Fraud," Committee on Education and the Workforce, U.S. House of Representatives, November 25, 2003.

(Indeed, by early January, few families would have the W-2s and other documents needed to begin assembling their returns). This option would unduly delay grant payments to the individual students and colleges.

A second alternative, which H.R. 3613 favors, would still require the student's family to submit the same tax information, but the information would be verified later in the year. Since Pell Grants typically are disbursed in two payments—for the fall and spring semesters—verification could probably be completed before the spring disbursement. If a student provided faulty information to the Department of Education, it would likely be caught during this audit period, and the federal government could reduce or eliminate the spring grant payment as needed. In the case of fraudulently obtained grants, the Department of Education could more easily extract repayment or levy civil or criminal penalties, if warranted.

The Higher Education Act of 1998 provided for such increased data sharing, but this could not be fully realized because the Internal Revenue Code was not also amended to allow data sharing.¹³ H.R. 3613 would amend Section 6103 of the Internal Revenue Code to allow such data sharing between the IRS and the Department of Education. However, even if H.R. 3613 were enacted, next year's reauthorization of the Higher Education Act would still need a provision continuing this kind of data sharing.

Privacy Concerns

Opponents of this kind of data sharing have raised privacy concerns that, generally speaking, center on the government's ability to keep private data, such as tax information, confidential. As the argument contends, opening up IRS data to other agencies increases the chances that confidential tax data will be released to unauthorized individuals.

The IRS already shares tax data on a limited basis with the Department of Education, which appears to have a good track record in maintaining confidentiality. The Income Contingent Repayment (ICR) plan, one of the federal Direct Student Loan repayment options, already uses data from the IRS to calculate monthly loan payments.¹⁴ This program allows individuals to pay a percentage of their income toward their student loan debt. In most cases, this amount is far less than a traditional 10-year student loan repayment schedule, which especially benefits recent graduates whose incomes remain fairly low. To participate, students must allow the IRS to share their income information with the Department of Education. About 100,000 new individuals sign up to participate each year.¹⁵

About a year ago, a small-scale pilot program of less than 150 applicants selected into the verification program asked the applicants (and their parents) to allow the IRS to release their tax information directly to the Department of Education. This project was intended to increase the speed and efficiency of the verification process by taking the aid recipient and his or her family out of the process, allowing the Department of Education to receive information directly from the IRS. According to the GAO, initial feedback from students, parents, and the Department of Education was very positive.

Broadening this data sharing to include all federal student aid recipients is a reasonable next step. It would reduce the burden on the 30 percent of aid applicants who are currently selected for verification. This alone would save substantial time and money by reducing fraud, limiting the applicants' burden, and streamlining administrative costs.

Finally, and perhaps most important, restricting data sharing to the narrow purpose of verifying information that student aid applicants provide should ease privacy concerns because the only data the IRS would be sharing with the Department of

13. For commentary on this point, see U.S. General Accounting Office, *Taxpayer Information: Increased Sharing and Verifying of Information Could Improve Education's Award Decisions*, pp. 2–3.

14. This data sharing between the IRS and the Department of Education is specifically allowed under the Internal Revenue Code, Section 6103(l)(13).

15. Beyond the Income Contingent Repayment program, the IRS provides the Department of Education with a list of last known addresses for those who default on their student loans. Under this program, known as the Taxpayer Address Request program, the IRS forwards approximately 4.6 million addresses to the Department of Education each year.

Education are data that the department already receives directly from applicants under current law.

What Congress Should Do

Data sharing is a viable way to rid the Pell Grant and other student aid programs of waste and abuse. The General Accounting Office, the House Education and the Workforce Committee, and the Office of Management and Budget estimate that data sharing between the IRS and the Department of Education could realize savings of roughly \$300 million per year in reduced fraud and total savings of as much as \$638 million per year. To achieve this, Congress should:

- **Maintain** the provision in the 1998 reauthorization of the Higher Education Act that allows increased data sharing between the IRS and the Department of Education.

- **Amend** Section 6103 of the Internal Revenue Code to allow data sharing between the IRS and the Department of Education for the narrow purpose of verifying postsecondary student eligibility for federal aid.
- **Continue** to penalize students who grossly misrepresent their resources in order to secure higher amounts of federal student aid, forcing repayment and assessing fines as warranted.

These simple measures are an easy way for Congress to reduce fraud, increase the funding available to low-income students, and streamline a large part of America's postsecondary student aid system.

—Kirk A. Johnson, Ph.D., is Harry and Jeanette Weinberg Fellow in Statistical Welfare Research in the Center for Data Analysis at The Heritage Foundation.