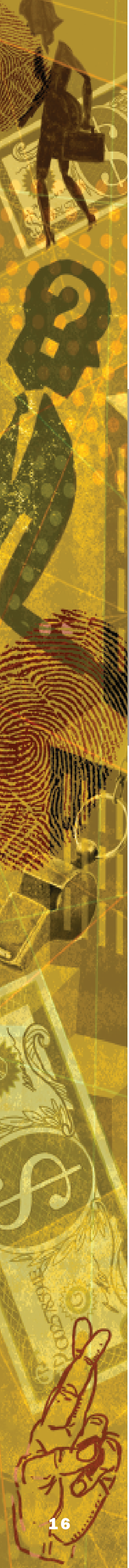
Curtis C. Verschoor, CMA, Editor



Do For-Profit Colleges Deserve Taxpayer Support?

Students at for-profit colleges have a much higher dropout rate and frequency of student loan defaults when compared to those at traditional public and private colleges and universities. In addition, a GAO report shows that several of these schools employ unethical tactics in recruiting. Despite all that, these schools continue to earn large profits while taxpayers pick up the tab.

The for-profit college industry has come under a firestorm of controversy from a number of sources for allegedly using misleading, possibly fraudulent, marketing and student recruiting practices. A speech by U.S. Senator Dick Durbin (D.-Ill.) compared some of these practices to those previously used in the subprime mortgage market. A scathing U.S. Government Accountability Office (GAO) report documenting these charges was first issued in August 2010 but was then heavily revised and later reissued. In February 2011, a lobbying group of for-profit colleges filed suit against the GAO, alleging negligence and malpractice in its investigation.

The original GAO report, *For-Profit Colleges: Undercover Testing Finds Colleges Encouraged Fraud and Engaged in Deceptive and Questionable Marketing Practices*, noted that many college encounters were without any hint of wrongdoing but that there were examples of ethical misconduct in several of the schools visited:

- Offering commissions to admissions officers.
- Use of deceptive marketing tactics, including the refusal to disclose total tuition cost to prospective students before they signed a binding agreement.
- Providing misleading information about accreditation.
- One case of encouraging outright fraud by enticing a student to apply for aid and hide the fact that the applicant had $250,000 in savings.
- Promising students they would get extravagant, unlikely high salaries after graduation.
- Failure to disclose actual graduation rate.
- Mentioning tuition cost equivalent to nine months of study when the actual course covered 12 months.

There are many supporters of the for-profit model of obtaining career-oriented post-secondary education as an alternative to the traditional state-supported or private nonprofit institution. They believe for-profits provide needed opportunities for the disadvantaged to obtain a college degree or certificate enabling them to move up in life. Critics point to the unethical aspects of actively recruiting students with the promise of a well-paying job after graduation when that promise commonly goes unfulfilled. These circumstances result in high dropout rates and the waste of taxpayer funds because students are often unable to repay their tuition loans. According to various sources, 9% to 12% of post-secondary students enroll in a for-profit institution but receive roughly 25% of all Federal Pell Grants and loans. Senator Durbin stated, "We're seeing too many examples where students go deeply into debt and either wind up with no diploma or a worthless diploma."

A series of reports by the U.S. Senate Education Committee has revealed unfavorable aspects of the huge federal government investment in this industry. In a preliminary study, the chairman of the Senate committee reported in September 2010 that more than 87% of revenues at 14 large for-profit schools came directly from the federal government. Financial aid per student at for-profit colleges is twice the amount provided to those at state-supported or private schools. Yet the report noted that eight publicly held educational corporations used approximately half of their expenditures for noneducational purposes, including student recruitment, marketing, and administration.

Another metric in which for-profit colleges find embarrassment compared to their nonprofit counterparts is excessive executive compensation. Robert Silberman, CEO of Strayer Education, Inc., received $41.9 million in 2009, according to an analysis by *Bloomberg Businessweek*. That's 24 times the amount awarded to the highest-paid Ivy League university president, Columbia's Lee Bollinger. The latest *Chronicle of Higher Education* report for 2008 shows Bollinger's total remuneration, including housing and other benefits, was $1.75 million. Second to Silberman among for-profit CEOs was Bridgeport Education Inc.'s Andrew Clark, whose 2009 compensation was $20.5 million.

Top executives at for-profit colleges also received a combined $2 billion from the sale of company stock since 2003. Analysis of SEC records by *Bloomberg Businessweek* showed the largest amount was to Apollo Group, Inc.'s founders Peter and John Sperling, who together received $837.8 million. The father and son still hold shares worth approximately $750 million. Apollo, parent of global giant University of Phoenix, Inc., reported that its first fiscal quarter 2011 total enrollment was more than 438,000 students.

In spite of paying generous compensation to its executives, the for-profit college industry generally seems to show high returns for its shareowners. In March 2011, Apollo's net profit on revenues was a healthy 11.23%, with a robust 37% annual return on equity. At the same time, DeVry, Inc., which provides a wide variety of post-secondary education services and has $2 billion in revenue, had a net profit percentage of 15% and return on equity of 27.1%, while Strayer Education showed a net profit margin of 20.61% and return on equity of 72.58%. (All numbers reported by dailyfinance.com.)

Perhaps the most significant unfavorable comparison of for-profit colleges to private and public nonprofit colleges and universities involves defaults on student loans. A primary reason for default is the high dropout rate from for-profit institutions. The dropout rate in the 2008-2009 school year was more than 50%. The overall student loan default rate within three years of beginning repayment rose to 13.8% last year (from 11.8%), according to a report released February 4, 2011, by the U.S. Department of Education. This overall rate masks a wide disparity between the default rates for students at for-profit institutions (25%) vs. those for students at publicly supported (10.8%) and private (7.6%) institutions.

The reported default rates may well understate the scope of the delinquency problem. There's no required reporting of what percentage of unpaid loans is in deferment or forbearance status. These are options that allow students to delay payment but still incur interest.

In addition to higher rates of default, the nonprofit group Education Trust reports that graduates of for-profit colleges have median debt of $31,190 compared to median debt of $17,040 for students at private nonprofit institutions and $7,900 for those at state-supported colleges. In addition, the rate of graduation is 22% at for-profit colleges, much less than the rate at state colleges of 55%. U.S. law treats education debt differently than other debts like credit cards or even subprime mortgages. Student loan obligations can rarely be discharged through personal bankruptcy, which means they stay with the individual—enabling garnishment of salaries, government benefits, or tax refunds—and disqualify students from getting future educational grants or other aid.

The governmental solution to the apparent misspending of taxpayer dollars was the development of what has become known as the "gainful employment" rule. This would end federal aid to college programs where student debt was

continued on page 25

For guidance in applying the *IMA Statement of Ethical Professional Practice* to your ethical dilemma, contact the IMA Ethics Helpline at (800) 245-1383 in the U.S. or Canada. In other countries, dial the AT&T USADirect Access Number from www.usa.att.com/traveler/index.jsp, then the above number.

Ethics

continued from page 18

too high and the percentage of borrowers repaying their student loans was too low. Lobbyists for for-profit colleges have spent large sums of money pushing an alternative that would require colleges to provide prospective students with more information about their graduates' debt levels and salaries. In effect, the alternative regulation would attempt to spell out what an ethical vendor should say and do. The rule is scheduled to become effective in July 2011.

In January 2011, the *Chronicle of Higher Education* reported that the for-profit college trade association has filed suit against the U.S. Department of Education to stop it from putting three new rules into effect. One rule is designed to prevent misrepresentation in recruiting, another ends the tying of compensation to enrollment, and the third gives states greater oversight over distance education. On February 18, 2011, the U.S. House of Representatives voted to eliminate any spending that would put into place new rules that could prevent students at for-profit colleges from accessing federal aid.

Questions:

1. Can government legislate what constitutes unethical behavior?
2. If so, can government bureaucracy meaningfully enforce such a decision without micromanaging an industry?

Underlying the entire controversy is the question of whether taxpayers should subsidize a highly profitable industry. Your comments are welcome. **SF**

Curtis C. Verschoor is the Ledger & Quill Research Professor, School of Accountancy and MIS, and an honorary Senior Wicklander Research Fellow in the Institute for Business and Professional Ethics, both at DePaul University, Chicago. He is also a Research Scholar in the Center for Business Ethics at Bentley University, Waltham, Mass. His e-mail address is curtisverschoor@sbcglobal.net.