

**FRAUD, ABUSE, WASTE, AND MISMANAGEMENT OF  
PROGRAMS BY THE DEPARTMENT OF HEALTH,  
EDUCATION, AND WELFARE**

**NCJRS**

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**HEARINGS ACQUISITIONS**  
BEFORE THE  
**PERMANENT**  
**SUBCOMMITTEE ON INVESTIGATIONS**

OF THE  
**COMMITTEE ON**  
**GOVERNMENTAL AFFAIRS**  
**UNITED STATES SENATE**  
**NINETY-FIFTH CONGRESS**

**SECOND SESSION**

**JULY 20, 1978**

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## CONTENTS

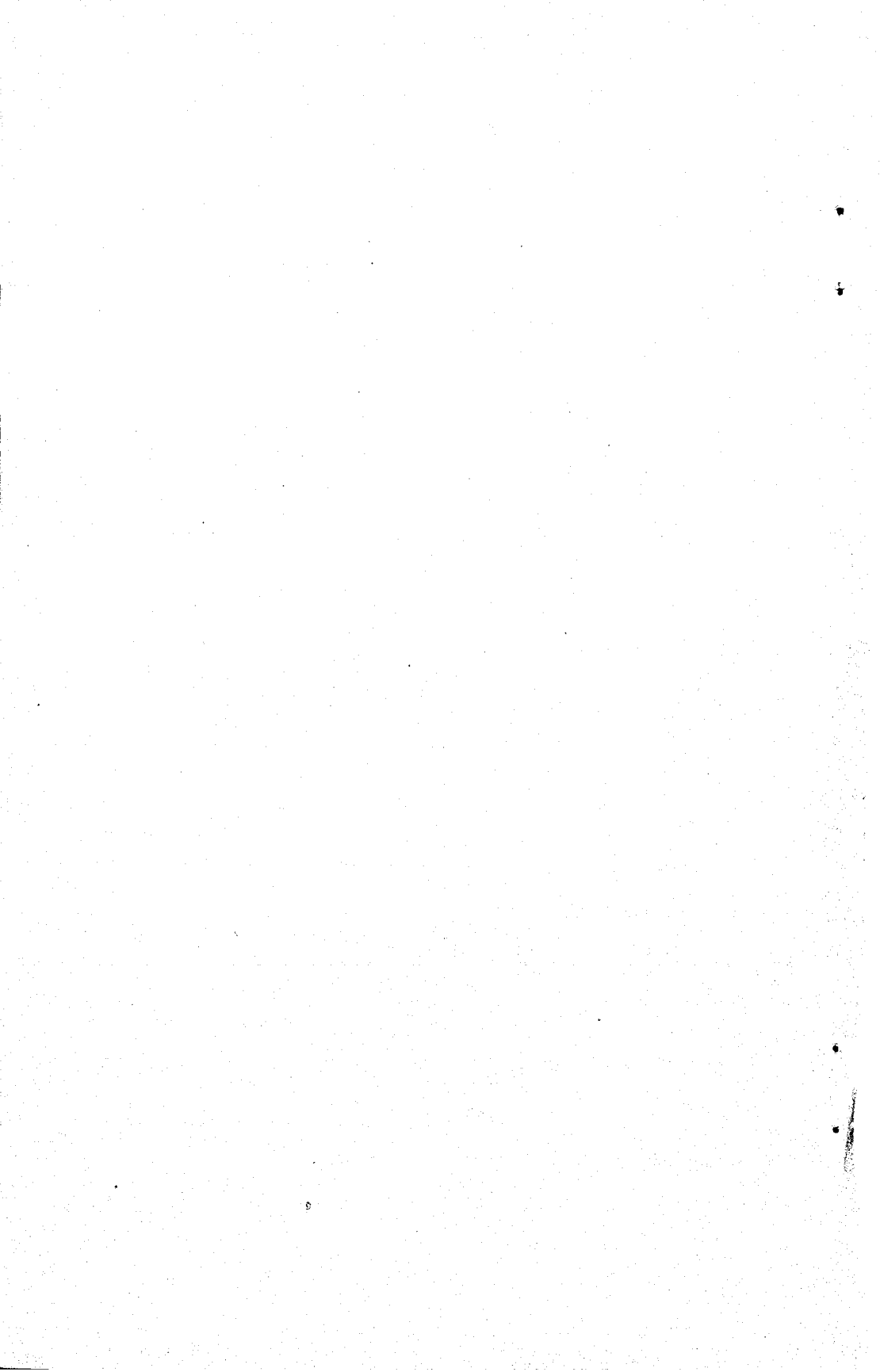
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Testimony of:	Page
Morris, Thomas, Inspector General, Department of Health, Education, and Welfare-----	5, 64
Ruff, Charles, Deputy Inspector General, Department of Health, Education, and Welfare-----	5, 64

## EXHIBITS

1. Memorandum dated May 18, 1978, with attachments, from the Inspector General to the Secretary, Department of Health, Education, and Welfare re revision and clarification of "Best Estimates" of losses due to fraud, abuse, and waste in HEW programs-----	7
2. Letter dated June 6, 1978, with attachments, from Joseph A. Califano, Jr., Secretary of HEW to Members of Congress re fraud, abuse, and waste problems-----	26

(III)



# FRAUD, ABUSE, WASTE, AND MISMANAGEMENT OF PROGRAMS BY THE DEPARTMENT OF HEALTH, ED- UCATION, AND WELFARE

THURSDAY, JULY 20, 1978

U.S. SENATE,  
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS  
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,  
*Washington, D.C.*

The subcommittee met at 9:07 a.m., pursuant to call, in room 6226, Dirksen Senate Office Building, under authority of S. Res. 370, agreed to March 6, 1978, Hon. Sam Nunn, presiding.

Members of the subcommittee present: Senator Sam Nunn, Democrat, Georgia; Senator James R. Sasser, Democrat, Tennessee; Senator Charles H. Percy, Republican, Illinois; and Senator Jacob K. Javits, Republican, New York.

Members of the professional staff present: Owen J. Malone, chief counsel; David P. Vienna, investigator; Joseph G. Block, general counsel to the minority; Stuart M. Statler, chief counsel to the minority; Ruth Y. Watt, chief clerk; Rosemary Steward, assistant clerk; and Peter Roman, aide to Senator Chiles.

Senator NUNN. The subcommittee will come to order.

[Members of the subcommittee present at time of convening: Senators Nunn and Javits.]

Senator NUNN. Senator Jackson has three other meetings this morning and cannot be here, but I would like for his statement to be inserted in the record, without objection.

## STATEMENT OF SENATOR JACKSON

This morning's hearing focuses on the efforts being made by the Inspector General of the Department of Health, Education, and Welfare to cope with the fraud, abuse, and waste that besets Federal health, education, and welfare programs. The Inspector General's recent annual report estimated the loss to the taxpayers at more than \$5.5 billion in fiscal year 1977.

The fraud, abuse, and waste in these programs reported by the Inspector General is outrageous. The challenge is to eliminate it by flushing out the unscrupulous health providers, welfare cheats, and fraud artists who prey on these programs. We need action to improve program management to overcome waste. We need better means of detecting fraud. And we need more vigorous enforcement of our criminal laws to deter other would-be cheaters and fraud artists.

The Inspector General lays down his own challenge in his annual report—a \$5 billion problem. We want him to tell us today what he has done and what he is going to do to get at the problem.

HEW's Office of Inspector General is new to the Department. It was created—under the sponsorship of Senator Nunn, Senator Chiles, and Senator Percy here in the Senate—to bring unified, independent, objective direction to the audit and investigative functions of the Department. The Inspector General's job is to prevent fraud and abuse and keep the Congress and the Secretary currently informed about the problems and deficiencies he finds.

Few things trouble the American people and the Congress more than to see the tax dollars that have been dedicated to national health and welfare programs “ripped off” or wasted. The Inspector General's mission is to see to it that steps are taken to rid the Department of these problems.

I want to commend Senator Nunn for moving ahead with this very timely hearing and for his years of effort to rid these programs of their problems.

I look forward to hearing the Inspector General's testimony and his answers to the subcommittee's questions.

#### OPENING STATEMENT OF SENATOR NUNN

Senator NUNN. Senator Percy will be back in a few minutes, and at that time he will make any opening remarks he would like to make.

For more than 4 years the Permanent Subcommittee on Investigations has been involved in studying programs administered by the Department of Health, Education, and Welfare.

In an investigation of the guaranteed student loan program, we found that the Office of Education has so mismanaged this effort that it could not account for almost \$1 billion in outstanding loans. We found HEW officials taking money from trade school operations in exchange for favorable accrediting decisions. Witnesses invoked their fifth amendment right before this subcommittee. The investigation, when referred to the Justice Department, led to convictions of individuals in California and Texas.

In an investigation of prepaid health plans in the California medicaid program, we found extraordinary abuse of patients, diversion of Federal medicaid funds, and overall program mismanagement.

In yet another inquiry, we found an HEW official taking money from contractors whose proposals he was responsible for reviewing and approving as a Government employee. He was provided with a leased car and he was wined and dined by these contractors, some of whom claimed their payments to him were for his tutorial services.

As a result of the rather continuous litany of HEW program fraud, abuse, waste and mismanagement from this subcommittee, as well as other committees of the Congress, Senators Percy and Chiles joined me in sponsoring a bill to create the Office of Inspector General in HEW. I did not want to create a big new bureaucracy in HEW.

The purpose of our bill was twofold. First, we wanted to consolidate under one office the operations of the nearly 1,000 man audit agency

of HEW, as well as the operations of the then 10-man Office of Investigations. Second, through this consolidation, we hoped to provide a focal point within HEW from which internal efforts could begin to identify and deal with fraud, abuse, waste, and mismanagement.

Thomas Morris, who is here with us this morning, and Mr. Ruff, who is his capable assistant, were appointed in 1977. Mr. Morris was appointed Inspector General and Mr. Ruff Deputy Inspector General.

The Office of Inspector General was in operation for 9 full months of its first calendar year. In March of this year, the Inspector General released his first annual report. The most startling aspect of the report was the estimate that as much as \$7.4 billion in taxpayer funds is lost in HEW through fraud, abuse, and waste.

From what I have seen thus far, I am pleased to have taken a leadership role in sponsoring in the Senate the bill to create the Office of Inspector General.

For years Congress has continued to blindly increase the HEW budget without specific information of just how serious were the problems within the agency. Therefore, the Office of Inspector General is, in my view, a partner in a congressional effort to regain control of runaway spending in HEW with its extraordinary number of programs.

It is only through the identification of the problem areas that Congress can begin to even hope to develop a response to the massive management problems that beset the Government's largest agency.

I believe that the job of the Inspector General is made even more difficult by those who would rapidly expand Federal social programs. There are those in the Congress, as well as in the Department of Health, Education, and Welfare, as well as in the executive branch, who believe that if you throw money at a problem, the problem will go away.

When the Government finances the responses to social ills, it creates instantly a new industry, a financial constituency and a host of problems, because some of the people inevitably attracted to the Federal trough are those interested in a fast buck. Their success is directly related to the quality of program administration. The poorer the program management, the greater the potential for actual ripoff.

The creation of the HEW Office of Inspector General represents one of the first congressional efforts to slow down, to step back and to evaluate what is happening in HEW programs.

Nothing can undermine the social programs and the good efforts of people in HEW, and many people in Congress, and throughout the executive branch, more than rampant fraud and abuse in the management of the programs.

So we have asked Mr. Morris and Mr. Ruff to appear before us this morning to discuss the first 15 months of operation of the Office of Inspector General. We would like to know what kinds of problems have impeded your ability, Mr. Morris, to get your job done so that Congress can address them. To the extent you let us know of those problems, we want to address them. We would also like any suggestions that you might have for changes in existing law that would increase the efficiency of your Agency.

Senator Javits, we would be glad to hear any opening statement you have.

### OPENING STATEMENT OF SENATOR JAVITS

Senator JAVITS. I would like to make a brief statement because I am here, too, for a very specific purpose.

Mr. Chairman, I am the ranking member of the Committee on Human Resources. I believe that the Committee on Human Resources has the largest or as large a jurisdiction in respect of HEW as any other committee in the Congress.

We, too, are deeply concerned, one, with the findings of this report respecting a Government department; and two, the concept which is that just as Government departments are perfectly free to come up here and testify and find out what we are doing, we are just as free to go down there, right in their offices, and look into what they are doing.

Now I yield to no one in my deep human concern for the condition of Americans, especially depressed and oppressed Americans. Nor will I yield to anyone in my determination to root out all the gold-bricking and the fraud and the funny business which so sours the taxpayer on these efforts.

It is a fact that the problems which we deal with will not be solved by eliminating the excesses and wrongs which you gentlemen have found and which our subcommittee will find. They may or may not amount to a given percentage, but never enough to be decisive in determining the success or failure in my judgment of these efforts. But I do believe that they tend to discredit these efforts, and hence are extremely harmful to the people whom we are all trying to help, and that includes our chairman and every other member of this Permanent Subcommittee on Investigations.

So I join the chairman in our profound effort to root out fraud and evil in these matters. I will take very seriously your findings, and I promise our committee, our subcommittee, I will make it my solemn business as a member of both committees to see that they are followed through from the legislative committee side, so far as we are concerned, and action is taken, as indeed we took action respecting findings in the brilliant work done by this subcommittee in the college loan program.

I thank the chairman.

Senator NUNN. I thank you, Senator Javits. I think we are indeed fortunate to have you in a key position on this subcommittee and also on the legislative committee dealing with this matter. In every case that I know of where we have made findings in HEW programs, or any other programs, under the jurisdiction of the committee you serve on, you have taken action.

I think this is a unique partnership.

Senator JAVITS. Thank you.

Senator NUNN. Mr. Morris?

Mr. MORRIS. Mr. Chairman, I will be glad to proceed as you would wish, either to read my statement or highlight it. I would like to be at your disposal. Would you care if I read it, sir?



Senator NUNN. That would be fine.

Mr. MORRIS. We appreciate this opportunity—

Senator NUNN. We need to swear you in. We have a rule we swear in all witnesses here. If Mr. Ruff is going to testify, we will swear him in also.

Mr. MORRIS. Yes.

Senator NUNN. Will you each raise your right hand? Do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. MORRIS. I do.

Mr. RUFF. I do.

### TESTIMONY OF THOMAS MORRIS, INSPECTOR GENERAL, AND CHARLES RUFF, DEPUTY INSPECTOR GENERAL, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

Mr. MORRIS. We appreciate particularly the chance to appear before this committee, Mr. Chairman, because of the contribution which the committee has made in the creation of our Office in Public Law 94-505. As you pointed out, we are approximately 15 months old. The first thing we observe is that each quarter of our existence has witnessed new developments in our work and priorities. We found we have a very dynamic workload, and it is yet too early to predict what our normal pattern of effort will or should be.

This morning we would like to cover briefly five matters. First, to highlight the findings of our annual report submitted on March 31. Second, to review for you the status of two special projects. Third, to discuss our workload versus our staffing. Fourth, to review certain special issues that we know are of interest to you. Last, to draw some conclusions.

Turning to our first year and our first annual report. That report endeavored to review performance and present recommendations based on the 12 months which began last April 1, 1977. We believe it is still a current document, but we will update various portions in this statement.

First of all, let me discuss the "best estimates" of fraud, abuse and waste, to which you have referred. One of the innovative efforts which we tried to undertake in this first year was to inventory major areas of opportunity for the department as a whole to achieve greater economy and efficiency, as well as to detect and prevent fraud and abuse. The inventory found the following:

First: Based on congressional hearings, GAO studies, as well as HEW's own past studies, it appears to us that over time, the department should seek to reduce its costs by several billion dollars.

The inventory showed estimates of possible losses in the range of \$5.5 to \$6.5 billion, or about 5 percent of the expenditures concerned.

The auditors who prepared the inventory stressed, however, that in no sense are all of these so-called losses fully recoverable. There is no such thing as a zero error rate in programs which involve millions of beneficiaries receiving payments from hundreds of different agencies.

In fact, the report was later modified in my memorandum to the Secretary dated May 18, 1978, a copy of which I would be pleased to furnish for the record, in which the estimated losses were reduced by about \$838 million and further placed in the following four categories. I think this is very important, Mr. Chairman. We tried to allocate each of the 37 items studied into one of four groups:

(A) The first are those activities and items which the Secretary can attack under his present authority and present resources. That loss estimate proved to be about \$2.7 billion based on 1977 data.

(B) The second are those additional losses which he can attack but which require more resources. These losses are just under half a billion dollars.

(C) Third are those matters which require new legislation. Those losses proved to be about \$1.2 billion.

(D) Finally, certain areas need further study and research before the potentials for cost reduction can be established. They range from \$1 to \$2 billion.

We would be glad to further discuss these matters in this hearing, but I would like to offer the highest commendation to Secretary Califano and to the key officials of the Department for their vigorous plans to seek greater economy and efficiency.

Following our report, cost reduction targets were officially approved by the Secretary in his directive dated June 6, 1978, which expressly recognized the findings of the Inspector General's Annual Report. I would also like to submit that directive for the record.

Senator NUNN. It will be a part of the record.

Mr. MORRIS. Thank you, sir.

Senator NUNN. Without objection we will make the May 18, 1978 memorandum exhibit No. 1 and the June 6, 1978 directive exhibit No. 2.

[The documents referred to were marked "Exhibits No. 1 and 2" for reference and follow:]

## EXHIBIT No. 1

F O R R E L E A S E

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE  
OFFICE OF THE SECRETARY  
WASHINGTON, D.C. 20201

May 18, 1978

MEMORANDUM

TO : The Secretary  
Through: ES \_\_\_\_\_

FROM : The Inspector General

SUBJECT: Revision and Clarification of "Best Estimates" of Losses due to Fraud, Abuse, and Waste in HEW Programs

On March 31, 1978, we reported to you and to the Congress an inventory of "best estimates" collected from numerous sources, regarding the losses believed to be occurring in HEW programs. We stressed in the annual report:

- That the estimates range from well-established and scientific error measurement systems (such as those in AFDC and Medicaid) to simply the judgments of well-informed spokesmen in the Department, the Congress and outside organizations.
- That there might well be duplications or double counting (we have, in fact, found several).
- That the estimates were not complete.
- That the reader should recognize that the estimates do not represent monies that are fully recoverable.

We further stressed in the report that "fraud and abuse," as such, was the smallest part of the losses. In fact, only 15 percent of the estimates were attributed to unlawful, willful misrepresentation (fraud) or excessive services and program violations (abuse).

Despite these caveats, we have been distressed that the press and the public in many cases have construed the estimates to

be totally attributable to fraud and abuse. Further, there has been an assumption that the entire amount of the estimates can be recovered simply by stopping wasteful practices. This, of course, is simply not true.

To put the matter into perspective, we have worked with Mr. Schaeffer and the Principal Operating Component Heads to obtain any additional information which they could furnish to help us refine the estimates, and to further analyze the extent to which reductions are possible under their current statutes and budgets.

As a result of these reviews, the estimates have been reduced by \$838 million (as explained below). The amounts on which significant action can be taken under present authorities and resources are less than half of the total. With respect to these amounts--\$2.7 billion--we are pleased to note that the cost reduction goals which have been developed by the POCs, working with Mr. Schaeffer, are designed to produce significant savings in 1979, 1980, and 1981.

REDUCTION IN LEVEL OF ESTIMATES  
BY \$838 MILLION

	(Million)	
	<u>Original</u> <u>Estimates</u>	<u>Revised</u> <u>Estimates</u>
Low	\$ 6,333	\$ 5,521
High	7,370	6,532

Of the \$838 million in reductions, \$431 million result from errors made by the OIG in interpreting the data. The most important source--over \$200 million--is double counting of certain of the losses in the AFDC, SSI, and Guaranteed Student Loan programs. Quality Control measurement had already reflected losses which we separately reported as "fraud and abuse" in the AFDC program.

Also, we incorrectly reported "provider overpayments" under Medicare as a total loss of \$141 million. We later found that this amount is substantially all recovered in subsequent collections.

The remaining one-half of the reduction is attributable to new information furnished to us by the POCs in several areas.

In summary, the original and revised estimates are as follows:\*

<u>Program</u>	<u>Original Estimates</u>	<u>Revised Estimates</u>
Health Cost	4,489-4,819	3,875-4,193
AFDC	635	468
SSI	333	292
SSA	159-866	173-866
Social Services	(88)	See "unmet audit needs"
SFA Programs	345	321
ESEA Title I	97	97
Indirect Cost Negotiations	102	107
Unmet Needs	<u>173</u>	<u>188</u>
Total	6,333-7,370	5,521-6,532

\*These are further discussed in my memorandum of April 30, 1970, a copy of which is attached.

LESS THAN 50 PERCENT OF ESTIMATES ARE  
AMOUNTS ON WHICH SIGNIFICANT REDUCTION  
ACTIONS CAN BE TAKEN UNDER PRESENT  
AUTHORITIES AND RESOURCES

We classified each of the estimates as to:

- Those on which savings can be realized now under present authorities and approved budgets (assuming FY 1979 budget requests are granted).
- Those where action can be taken if additional resources are provided in the FY 1980 budget.
- Those where further action will require new statutory authority.

- Those where further study and research is needed to assess the extent of losses and to develop new knowledge on how to cope with the problems.

We are summarizing below our findings under these four headings:

<u>Extent To Which HEW Can Make Savings</u>	<u>Estimated Losses FY 1977</u>
A. Now, under present authority and resources	2,741
B. In 1980 and beyond, using existing authority, but requiring more resources	491
C. When Congress passes new legislation	1,217
D. Uncertain until further studies are completed	<u>1,072-2,083</u>
Total	5,521-6,532

A. LOSSES WHICH CAN BE SIGNIFICANTLY ATTACKED  
UNDER EXISTING AUTHORITIES AND RESOURCES

<u>Sources of Loss</u>	<u>Amount (Million)</u>	<u>Comment</u>
1. Medicaid payments to ineligible; third-party liability; erroneous payments	\$ 1,100	
2. Medicaid fraud and abuse, including unnecessary nursing home costs	668	Number is incomplete and probably low.
3. Medicare cost report reviews	17	

4. Unnecessary hospital stays	124	Based on PSRO review.
5. SSI--erroneous payments	292	
6. AFDC--erroneous payments	206	See further losses requiring additional resources to attack. (Section B below)
7. SFA Programs	203	Same as above
8. ESEA Title I	53	Same as above
9. Indirect Cost Negotiations	23	Same as above
10. Unmet Audit Needs	<u>55</u>	Same as above
Total	2,741	

B. ADDITIONAL LOSSES WHICH CAN BE ATTACKED  
IF MORE RESOURCES ARE PROVIDED IN FY 1980

<u>Sources of Loss</u>	<u>Amount (Million)</u>	<u>Comment</u>
1. AFDC--erroneous payments	112	The additional resources are needed for technical assistance and management reviews of State systems.
2. SFA Programs	118	Additional staffing is required to support expanded collection efforts.
3. ESEA Title I	44	Provides for increased monitoring and auditing.
4. Indirect cost negotiations	84	Provides for increased staff to support negotiations.
5. Unmet Audit Needs	<u>133</u>	Provides increased audit effort. (Now only about 50% of desired level).
Total	491	

C. ADDITIONAL LOSSES WHICH CAN BE ATTACKED  
IF NEW LEGISLATION IS ENACTED

<u>Sources of Loss</u>	<u>Amount (Million)</u>	<u>Comment</u>
1. Medicaid/Medicare Common Audit	*41	Provides for common audits of hospitals, nursing homes, and HMO's. Some States do not participate now.
2. Medicare--Renal Dialysis	**92	Pending legislation will permit increased home dialysis and improved cost data.
3. Excessive Hospital Beds	894	Legislation now pending provides closure and conversion. Further authority may be desired to restrict reimbursement when new construction is denied.
4. Excessive Physician Costs	40	Legislation pending deals with "ancillary hospital costs."
5. AFDC	<u>150</u>	Provides revisions in HR 7200 to strengthen State Administration.
Total	1,217	

D. AREAS REQUIRING FURTHER STUDY BEFORE  
ESTABLISHMENT OF LOSS ESTIMATE BY  
POCs AND POTENTIAL COST REDUCTIONS

The remaining four items involve large areas of potential loss and savings, about which considerable uncertainty exists. Hence, further study or research is needed.

\*Note: As of 6/5/78 the proposal was pending OMB clearance.

\*\*Note: As of 6/5/78 this bill had passed the Congress and was pending Presidential action.

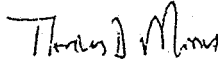


<u>Sources of Loss</u>	<u>Amount (Million)</u>	<u>Comment</u>
1. Excessive Nursing Differential	185	HCFA reports that a preliminary study is in process. Current Talmadge bill may eliminate the problem.
2. Unnecessary Surgery	282 to 600	Amount is under study. \$282 million is the first time HCFA has estimated a specific number. The second opinion program may help.
3. Unneeded and Repeat X-Rays	432	Opportunities for cost reduction depend upon long-range improvements through training of technicians, development of better criteria to guide x-ray practices. Involves PSRO reviews. Will be difficult to track.
4. SSA Title II Error Measure- ment	<u>173-866</u>	System will not begin operation until October. Range of error losses may exceed \$1 billion. In the meantime, any amount is speculative.
Total	1,072-2,083	

COMMENTS ON THE RECOVERABILITY  
OF ESTIMATED LOSSES

In my judgment, the complexity and difficulty of many of the losses cited in the inventory far exceed those of other Federal agencies. With many millions of recipients receiving monthly payments--and with eligibility systems administered through hundreds of offices, many under State and local control--and with eligibility dependent upon the willingness of individuals to report changes in their status--errors and losses are inevitable.

I have made an initial review of the loss reduction goals thus far submitted by the Principal Operating Components. I feel that their achievement over the next three fiscal years would be an outstanding accomplishment. I am particularly impressed with the fact that initiatives based on "present authorities and resources" are aimed at saving almost two-thirds of the losses which can now be attacked. It is the goal of this Office to contribute to this achievement through expanded audit, aggressive investigation of fraud, and practical ideas for improving systems of detecting errors and preventing abuses.



Thomas D. Morris

Attachments

## MEMORANDUM

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE  
OFFICE OF THE SECRETARYTO : The Secretary  
Through: ES \_\_\_\_\_

DATE: April 30, 1978

FROM : The Inspector General

SUBJECT: Revised Best Estimates of  
Fraud, Abuse and Waste

During the week of April 24, 1978, we reviewed each of the estimates with the POCs and made a number of revisions as detailed in Attachments A, B and C.

The resulting estimates are revised downward as follows:

	(Millions)	
	<u>Original Estimates</u>	<u>Revised Estimates</u>
Low	\$ 6,333	\$ 5,521
High	7,370	6,532

The details of the reduction (Attachment B) show that

--Half (\$431) are the result of OIG errors  
due in part to unintended double counting.

--Half (\$407) are due to new data presented  
by the POCs this week.

There are remaining differences with HCFA and are shown in Attachment C.

We are prepared to discuss these revisions at our hearing before Senator Nunn during the week of May 21.

*Tom Morris*  
Thomas D. Morris

Attachments

cc: Mr. Champion  
Mr. Schaeffer

4/30/78  
ATTACHMENT A  
Page 1 of 7

OFFICE OF INSPECTOR GENERAL  
REVISION IN "BEST ESTIMATES" OF  
FRAUD, ABUSE AND WASTE  
FY 1977 (MILLIONS)

PROGRAMS AND ITEMS	ORIGINAL ESTIMATE	REVISED ESTIMATE	**REASON	COMMENT
<u>Medicaid</u>				
1. Payments to Ineli- gibles, Third-Party Liability Losses, Erroneous Payments (Page 77, Items 1, 3, 4)	770- \$ 1,100	\$ 1,100	No Change	POC and IG agree
2. Fraud and Abuse (Page 77, Item 2)	468	468	No Change	POC recommends \$100 million. All agree num- bers are "soft". IG considers low.
3. Common Audit (Page 77, Item 5)	50	35	2	
4. Quarterly Reviews and Audit Excep- tions	35	*	-	*See "Unmet Audit Needs"

\*\* REASONS

- 1--OIG Error or Misunderstanding  
2--New Data Presented by POC Week of 4/24/78

PROGRAM AND ITEM	ORIGINAL ESTIMATE	REVISED ESTIMATE	REASON	COMMENT
<u>Medicare</u>				
1. Excess Nursing Differential (Page 82, Item 1)	\$ 185	\$ 185	No Change	POC disagrees un- til preliminary study (in process) is completed.
2. Renal Dialysis (Page 82, Item 2)	153	92	(2)	POC recommends \$55 million pend- ing completion of cost studies
3. Provider Overpay- ments Recovered (Page 82, Item 3)	141	0	(1)	All recoveries removed from "Best Estimates"
4. Cost Report Reviews (Page 82, Item 4)	16	17	(2)	
5. Common Audit (Page 82, Item 5)	8	6	(2)	POC and IG agree
6. Audit Exceptions (Page 82, Item 6)	3	*		*See "Unmet Audit Needs"

PROGRAM AND ITEM	ORIGINAL ESTIMATE	REVISED ESTIMATE	REASON	COMMENT
<u>Medicaid/Medicare</u>				
1. Excessive Hospital Beds (Page 87(a))	\$ 1,130	894	(2)	POC and IG agree
2. Unnecessary Surgery (Page 87(b))	655	282-600	(2)	POC now proposes \$282
3. Unnecessary Hospital Stays (Page 87(c))	124	124	No Change	POC agrees
4. Excessive Physician Cost (Page 88(d))	73	40	(2)	HCFA legislative proposal: "Ancillary Hospital Services"
5. Unneeded X-Rays (Page 89(a))	400	400	No Change	POC and IG agree
X-Rays - Genetic Effects (Page 89(b))	84	0	(1)	Savings very long-range
Repeat X-Rays (Page 89(c))	32	32	No Change	POC and IG agree
6. Nursing Home Costs (Page 90)	200	200	No Change	POC and IG agree
<u>TOTAL HEALTH CARE</u>	4,489; to 4,819	3,875 to 4,193		POC proposes 3,285

PROGRAM AND ITEM	ORIGINAL ESTIMATE	REVISED ESTIMATE	REASON	COMMENT
<u>AFDC</u>				
1. Erroneous Payments (Page 91, Item 1)	490	462	(2)	POC and IG agree
2. Fraud and Abuse (Page 91, Item 2)	145	6	(1)	Most fraud and abuse covered in Quality Control Measures. Agree on double dipper loss of \$6 million plus.
3. Quarterly Reviews and Audit Exceptions (Page 91, Items 3, 4)	34	*	-	*See "Unmet Audit Needs"
<u>SSI</u>				
1. Erroneous Payments (Page 92, Item 1)	310	292	(2)	POC and OIG agree
2. Overpayments to Nursing Home Residents (Page 92, Item 2)	23	0	(1)	Covered in SSI Quality Control
3. Audit Exceptions (Page 92, item 3)	1	*	-	*See "Unmet Audit Needs"

PROGRAM AND ITEM	ORIGINAL ESTIMATE	REVISED ESTIMATE	REASON	COMMENT
Income Security <u>SSA</u>				
1. Erroneous Pay- ments (Page 98, Item 1)	159-866	173-866	(2)	\$173 is estimated non-recovery of "known" overpayments in 1977.  \$866 is estimate of unidentified over- payments not re- covered in 1977. (QC system in pro- cess)
Audit Excep- tions	1	*	-	*See "Unmet Audit Needs"
TOTAL SSA	1,127 to 1,834	933 to 1,626		POC agrees with 933 and probability of higher number when QC system is opera- tional



PROGRAM AND ITEM	ORIGINAL ESTIMATE	REVISED ESTIMATE	REASON	COMMENT
<u>Social Services</u>				
1. Quarterly Re-views and Audit Exceptions (Page 93, Item 1, 2)	88	*	-	*See "Unmet Audit Needs"
<u>Office/Education</u>				
1. BFOG (Page 94, Item 1)	109	109	-	POC and IG agree on 1977. Greater waste identified in 1978
2. Campus Based Program (Page 94, Item 2)	49	69	(2)	POC and IG agree
3. GSL (Page 94, Item 3)	187	143	(1)	Fraud and abuse double counted in defaulted loans.
4. Audit Exceptions (Page 94, Item 4)	11	*	-	*See "Unmet Audit Needs"
5. ESEA Title I (Page 100)	97	97	-	POC and IG agree
TOTAL OE	442	418	-	POC and IG agree

PROGRAM AND ITEM	ORIGINAL ESTIMATE	REVISED ESTIMATE	REASON	COMMENT
Indirect Costs (Page 99)	102	107	-	Revised to reflect po- tential <u>new</u> recoveries
Unmet Audit Needs	173	188	-	All-agreed-upon recoveries deleted from estimates  New estimate reflects potential <u>new</u> recov- eries
<u>RECAPITULATION</u>				
Health Care	4,489 to 4,819	3,875 to 4,193		
SSA	1,127 to 1,834	933 to 1,626		
EDS	(88)	*		Included in *Un- met Audit Needs"
OE	442	418		
Indirect Costs	102	107		
Unmet Audit Needs	173	188		
	6,333 to 7,370	5,521 to 6,532		

EXPLANATION OF \$838 MILLION REDUCTION  
IN HIGH "BEST ESTIMATES"

<u>ITEM</u>	<u>IG ERROR</u>	<u>NEW DATA SUBMITTED BY POC</u>	<u>TOTAL</u>
Medicaid Common Audit		- 15	- 15
Renal Dialysis		- 61	- 61
Provider Overpayment	-141		-141
Medicare Cost Reports Re- views		+ 1	+ 1
Medicare Com- mon Audit		- 2	- 2
Excess Hos- pital Beds		-236	-236
Unnecessary : Surgery		- 55	- 55
Excessive Physician Costs		- 33	- 33
X-Rays Genetic Defects	- 84		- 84

<u>ITEM</u>	<u>ERROR</u>	<u>NEW DATA</u>	<u>TOTAL</u>
AFDC Erroneous Payments		-28	- 28
AFDC Fraud and Abuse	-139 (Number is ok but double counted)		-139
SSI Erroneous Payments		-18	- 18
SSI Overpayments to Nursing Home Residents	-23 (Number is ok, but double counted)		- 23
OE Campus Based Programs		+20	+ 20
OE-GSLP Fraud and Abuse	-44 (Number is ok, but double counted)		- 44
Indirect Costs		+ 5	+ 5
Unmet Audit Needs		+15	+15
	<hr/> \$ 431	407	838

## ATTACHMENT C

REMAINING DIFFERENCES BETWEEN  
HIGH OIG AND POC ESTIMATES

<u>HEALTH CARE</u>	<u>OIG REVISED</u>	<u>POC REVISED</u>	<u>DIFFERENCES</u>	<u>COMMENTS</u>
1. Fraud & Abuse	468	100	368	HCFA agrees problem exists but cannot price out
2. Excess Nursing Differential	185	-	185	HCFA would need comprehensive study to price out. Preliminary study in process.
3. Renal Dialysis	92	55	37	Questions are: percent of home dialysis in 1977: 10%, 14%, or 20%; cost base used.
4. Unnecessary Surgery	282 to 600	282	318	Problems are: (1) offset for medical care in lieu of surgery; (2) incidence of unnecessary surgery.
			<hr/> \$ 908	

## EXHIBIT No. 2



THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE  
WASHINGTON, D.C. 20201

June 6, 1978

Dear Representative:

During the next few weeks, the Labor-HEW appropriations bill will be taken up in both Houses of the Congress. As a result of the first annual Report by HEW's Inspector General -- who, at my request, developed a rough estimate of the HEW funds unnecessarily or improperly spent in fiscal 1977 -- some members may propose flat, across-the-board reductions in the HEW budget in amounts the Inspector General identified.

Such an indiscriminate approach shows a serious misunderstanding of the fraud, abuse and waste problem and the effective ways to deal with it. Arbitrary, across-the-board cuts in the HEW budget -- especially out of the entitlement programs that aid our nation's older citizens and its sick, its disadvantaged children, its handicapped, and its poor -- will not reduce unnecessary or improper expenditures. Such meat-axe cuts will reduce the funds available for the millions of Americans who benefit properly from HEW programs, as the Congress intended.

A much more carefully targeted approach that focuses on ways of identifying and then rooting out fraud, error and waste is necessary if the Congress and the Executive are to make real progress in instituting systems that will ensure, to the greatest extent possible, the financial integrity of HEW's programs.

Indeed, there is no more important mission for the Secretary of HEW than the development of systematic initiatives to reduce substantially the dollars that are lost as a result of fraud, abuse or waste. Since becoming Secretary, I have devoted a great deal of my time to developing and implementing such initiatives.

Today I have sent a directive to the operating components of the Department setting targets for the reduction of dollars lost through fraud, abuse and waste. For your information, a copy of that directive is attached.

The targets are based on what we estimate we can do administratively with available knowledge and available resources. We will move as expeditiously as we can under existing legislation to stop the leakage of funds.

But, as the attached memorandum makes clear, Congress also has a vital role to play in helping Department administrators deal forcefully with problems of fraud, abuse and waste.

Let me give a salient example. More than half of the improperly or unnecessarily expended funds identified by the Inspector General are a result of wasteful costs associated with health care. And a large portion of that waste in health care costs could be eliminated if the Congress passes the President's Hospital Cost Containment legislation. If that legislation took effect on October 1, 1978, we could save \$730 million in Federal expenditures in fiscal 1979 (and over \$2 billion in the health care system as a whole).

The Congress has acted wisely in passing the Medicare-Medicaid Fraud and Abuse Amendments of 1977 and the Kidney Disease Reimbursement Improvements Act of 1978. For example, by providing kidney dialysis at home, the Kidney Disease Reimbursement Improvements Act will, it is estimated, save \$14 million in fiscal 1979 and \$40 million in fiscal 1980.

Indeed, while we estimate that moving administratively with existing resources and knowledge HEW can eliminate approximately \$1.7 billion lost to waste, abuse and fraud during fiscal 1980, we also estimate that Congressional action on pending legislation could result in an additional reduction of \$2.2 billion during the same period. In addition to Hospital Cost Containment, these bills include the Administration supported portions of H.R. 7200 and legislation to reauthorize elementary and secondary education programs.

I have made it a matter of overriding concern to mount a tenacious campaign to reduce improper and unnecessary expenditures. And in the last 17 months we have not only systematically begun to diagnose the problem but we have made progress with the cure. For example:

- A number of trends involving waste in HEW programs are pointing in the right direction:
  - Payment error rates in the SSI program are declining, from .1 percent in December, 1976, to 5.2 percent in September, 1977.
  - Payment error rates in the AFDC program are declining, from 8.5 percent in December, 1976, to 8.4 percent in December, 1977.

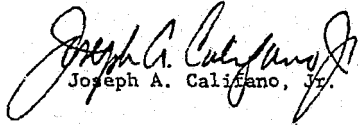
- Since we have begun a sustained effort to clean up the Federal student loan programs, the number of defaulters put in repayment status each week has more than quadrupled from fewer than 300 to an average of 1200 individuals.
- As a result of Departmental initiatives, we should eliminate more than a quarter of a billion dollars in waste in the 18 month period ending October 1, 1978. Savings include:
  - \$93 million in SSI as a result of error rate reduction;
  - \$50 million in AFDC as a result of error rate reduction; and
  - \$50 million in the Basic Educational Opportunity Grant program through improved techniques in validating applicants' financial statements; and
  - Over \$50 million in other reductions.
- We have undertaken innovative new programs to move systematically against fraud and abuse;
  - Project Match uses computer techniques to find Federal employees (both military and civilian) who are improperly receiving welfare benefits. We have already made more than 30,000 matches, and, of the first 1600 cases given careful review, more than 400 individuals were found to be either totally ineligible or receiving overpayments.
  - Operation Cross-Check uses computer techniques to identify those on the Federal civilian payroll who have not paid back Federal loans. More than 6700 possible defaulters have been identified, and, out of 317 defaulters in HEW alone, over half are now in repayment status (others are, for example, dead or bankrupt).
  - Project Integrity uses computer techniques to identify physicians and pharmacists in the Medicaid program who have been filing improper bills. Out of 2400 high priority cases, 517 are in full field investigation and, in the short time this program has been operating, these investigations have resulted in nine indictments, three convictions and the referral of 54 other cases to prosecutors.



In sum, a carefully coordinated and cooperative strategy developed jointly by the Congress and the Executive will yield the greatest results in an effort that must succeed -- the effective management of vital social programs with a minimum of fraud, abuse and waste.

Such a strategy does not include arbitrary cuts that fail to address in an effective fashion the problem of eliminating unnecessary and improper HEW expenditures and that will have the primary effect of hurting our nation's vulnerable citizens. I urge you to reject such ill-considered proposals.

Sincerely,

  
Joseph A. Califano, Jr.



THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE  
WASHINGTON, D. C. 20201

June 6, 1978

MEMORANDUM TO: Acting Commissioner, Social Security  
Administration  
Assistant Secretary for Education  
Administrator, Health Care Financing  
Administration  
Assistant Secretary for Health  
Assistant Secretary for Human  
Development Services  
Assistant Secretary for Management  
and Budget  
Commissioner of Education  
Inspector General

SUBJECT: Action Plans to Reduce Fraud, Abuse,  
and Waste

On April 25, I requested each Principal Operating Component (POC) of the Department to develop a plan to attack the problems of fraud, abuse, and waste in HEW programs that were identified in the Inspector General's first Annual Report. I have personally reviewed these plans and have considered your comments and those of the Assistant Secretary for Management and Budget and the Inspector General.

On the basis of this information, I have developed a detailed set of numerical targets for the reduction of fraud, abuse, and waste. The targets specify, in dollar amounts, the reductions that can be achieved in problem areas identified in the Inspector General's report, and in other problem areas that have come to light. Each of you will be responsible for meeting or exceeding these targets in the programs you administer. Attached to this memorandum is a list of these targets and related assignments.

I consider your efforts to achieve these goals to be of the highest priority. Fraud, abuse, and waste deprive this nation's most needy and vulnerable citizens of essential benefits, waste tax dollars, and erode public respect for the institutions of government. The reductions that can be achieved in these areas are a critical part of our ongoing efforts to discharge our public responsibilities with efficiency and integrity, and to demonstrate that compassionate social policy is consistent with strong, effective management.

In developing these numerical targets, the figures in the Inspector General's report were carefully examined and each of you has been given an opportunity to review, comment on and assess the basis for the numbers. As a result of that examination, the Inspector General has reduced some items and increased a few; overall he has reduced his estimate of the amount of fraud, abuse, and waste by \$838 million. Roughly half of this reduction is attributable to errors, due in part to unintended double counting. The other half of this reduction is attributable to newly available data that led the Inspector General to lower his original estimates. I have attached an explanation of these changes. ✓

Even as revised, however, the overall estimate of the amount of fraud, abuse, and waste -- ranging from \$5.5 billion to \$6.5 billion in FY 1977 -- demands further, urgent and tenacious action by the Congress and by the Department. Of the \$5.5 to \$6.5 billion, the Inspector General has reported more than half of the losses -- ranging up to \$3.79 billion -- can only be attacked through new legislative authority, additional resources, or, in some cases, through improved understanding after further analysis and study.

We intend to move vigorously now to stem the losses that the Inspector General estimates are subject to attack under current law and presently available resources. If we do not move vigorously to stem these losses, they will only grow, year after year, because of inflation, growth in the number of people served by HEW programs as a result of demographic, economic and legislative changes, and inclusion of programs not reviewed in the Inspector General's Report that I have asked him to include next year.

In close consultation with the Inspector General and the Assistant Secretary for Management and Budget, each of you has set ambitious but realistic targets that acknowledge human nature, the reality that there is no such thing as a perfect, error-free system, and the legislative and operational complexity of the programs for which you are responsible. Over a three year period, the Department seeks, as developed by you and summarized below, to recover almost 2/3 of the \$2.74 billion in losses that we can attack under current law, a target that the Inspector General believes would be an outstanding accomplishment in public management.

For Fiscal Years 1979 through 1981, the numerical targets and related assignments in your action plans call for reductions of:

-- a total of \$1.1 billion in 1979;

- a total of \$1.7 billion in 1980;
- a total of \$2.2 billion in 1981.

Because these projected savings targets will be affected by future changes in law and available appropriations, they will periodically be adjusted to incorporate such changes.

As the Inspector General also noted, elimination of much of the waste and abuse will require cooperative action by the Congress or additional resources to better police administrative performance in HEW. For example, the Congress is currently considering several pieces of legislation, most importantly Hospital Cost Containment legislation, which would accelerate the Department's efforts to eliminate fraud, abuse, and waste. If the Cost Containment bill and other pending legislative items become law, we estimate that the following additional savings can be realized:

- a total of \$ .84 billion in 1979;
- a total of \$2.19 billion in 1980;
- a total of \$4.04 billion in 1981.

As study and understanding proceed, to the extent that fraud, abuse, and waste can be reduced only through further legislative change or additional resources, I expect you to incorporate the initiatives necessary to achieve these savings in both your fiscal 1980 legislative program recommendations and your fiscal 1980 budget requests.

This priority effort to focus on the problems identified in the Inspector General's report should intensify and build on the many other important management initiatives we have begun over the past sixteen and one-half months. These include:

- Project Integrity, which uses computer techniques to screen Medicaid claims of doctors and pharmacists for fraud, abuse, and error. During the next twelve months, these efforts will be expanded to include such other providers as dentists and clinical laboratories.
- Project Match, which matches payrolls and welfare rolls to identify individuals improperly receiving cash assistance.
- Operation Cross-Check, which uses computer techniques to identify government employees who have defaulted on student loans.

- The reorganization that joined Medicare and Medicaid administration under the Health Care Financing Administration in order to manage more effectively the Federal health dollar and to reduce fraud, abuse, and error.
- The reorganization and consolidation of the student assistance programs to put them on a sound financial footing;
- Consolidation of all cash assistance programs under the Social Security Administration;
- Timely development of criteria for the establishment of State fraud and abuse units in Medicare and Medicaid as required by the Congress;
- Tightened control over grants and procurements;
- Development of major new accounting and quality control systems in Medicaid and Social Security benefits aimed at reducing error rates;
- Institution of a major initiatives tracking system to monitor departmental progress against specific measurable indicators of program performance, including the reduction of error rates;
- Proposing major welfare reform legislation that would consolidate all cash assistance programs on a single computer system to reduce fraud, abuse, and error.

As the Inspector General, the Assistant Secretary for Management and Budget and I have indicated to you, we realize that there is no way to totally eliminate every aspect of fraud, abuse, and waste in HEW programs. With many millions of recipients receiving monthly payments, with eligibility systems administered through hundreds of offices, and with eligibility dependent upon the willingness of individuals to report changes in their status, errors and losses, whether in private or public operation, are inevitable. Moreover, many of the programs that we fund are administered by States, localities, or private institutions, whose management systems are not under our control. At the same time, however, there are numerous steps that we can take -- both on our own and in cooperation with other institutions -- to reduce significantly the amount of fraud, abuse, and waste in HEW programs.

I am asking that on or before June 23, 1978, you submit to me an action plan which outlines the steps you will take to achieve the targets that have been established. This plan should include a timetable, the measures you will use to

demonstrate your progress, and quarterly milestones in terms of these measures. I am also asking that you identify any other areas that you believe are prone to fraud, abuse, and waste, and provide action plans for these areas as well. As new legislation is enacted and budget decisions are made which enable us to take more effective measures to reduce fraud, abuse and waste, your plans and reduction targets will be revised accordingly.

In addition, on the 15th day following each quarter (beginning with the quarter ending September 30, 1978), please submit to the Assistance Secretary for Management and Budget a status report indicating your progress compared with the targets. Within ten days thereafter, I will expect him to submit to me a summary of all POC quarterly reports.

The estimates established by the Inspector General do not embrace programs administered by the Office of Human Development Services. The administrative structure of these programs is such that a longer term audit process will be required to determine the incidence of fraud, abuse, and waste in these programs, and to establish meaningful targets for reducing any losses. Accordingly, I am asking the Assistant Secretary for Human Development Services to work with the Inspector General and the Assistant Secretary for Management and Budget to accelerate the audit process and other control mechanisms. I shall expect to receive an action plan for this effort on July 14, 1978, and quarterly reports beginning with the partial quarter ending September 30, 1978.

I know of no aspect of this Department's activities that is of more critical importance than the effective management of our programs. As I have said on numerous occasions, our compassion must be disciplined by efficiency and competence. This Department's capacity to provide urgently needed assistance to millions of vulnerable people will be directly enhanced by reducing fraud, abuse, and waste in our programs. I expect each of you to place the highest priority on reaching and, if possible, surpassing these numerical targets.

*Joseph A. Califano Jr.*

Joseph A. Califano, Jr.

Attachment

cc: Heads of OS Staff Offices  
Principal Regional Officials

June 6, 1978

EXPLANATION OF \$838 MILLION REDUCTION  
(Millions of Dollars)

<u>ITEM</u>	<u>ORIGINAL ESTIMATE</u>	<u>IG ERROR</u>	<u>NEW DATA SUBMITTED BY POC</u>	<u>TOTAL REVISION</u>	<u>EXPLANATION</u>	<u>REVISED ESTIMATE</u>
Savings from Medicaid/Medicare Common Audit	\$ 58		-\$ 17	-\$ 17	Revised estimate.	\$ 41
Increased Home Care for Renal Dialysis Patients	153		- 61	- 61	More patients are on home dialysis than original estimate showed.	92
Medicare Provider Overpayment	141	-\$141		- 141	These sums were recovered.	0
Excess Hospital Beds	1130		- 236	- 236	Cost to maintain is less than IG estimate.	894
Unnecessary Surgery	655		- 55	- 55	Revised estimate.	600
Excessive Physician Costs	73		- 33	- 33	Revised estimate.	40
X-Rays Genetic Defects	84	- 84		- 84	Revised estimate.	0

35

<u>ITEM</u>	<u>ORIGINAL ESTIMATE</u>	<u>IG ERROR</u>	<u>NEW DATA SUBMITTED BY POC</u>	<u>TOTAL REVISION</u>	<u>EXPLANATION</u>	<u>REVISED ESTIMATE</u>
AFDC Erroneous Payments	\$490		-\$28	-\$28	More recent data	\$462
AFDC Fraud and Abuse	145	-139		- 139	Double count; amount is included in Erroneous Payments.	6
SSI Erroneous Payments	310		- 18	- 18	More recent data	292
SSI Overpayments to Nursing Home Residents	23	- 23		- 23	Double count; amount is included in Erroneous Payments.	0
National Direct Student Loan Program	49		+ 20	+ 20	New data shows more leakage through excessive cash balance.	69
OE-GSLP Fraud and Abuse	187	- 44		- 44	Double count; amount is included in default estimate.	143
Unmet Audit Needs	173		+ 15	+ 15	Increased number of audits will uncover additional disallowed costs.	188
Other	118		+ 6	<u>+ 6</u>		124
				\$836		

36



TARGETS TO REDUCE FRAUD, ABUSE, AND WASTE IN HEALTH CARE  
FINANCING ADMINISTRATION (HCFA) PROGRAMS

Included below are the HCFA targets to be reached as part of the Department-wide objective to reduce fraud, abuse, and waste. Targets 1 through 7 are those that are planned to be achieved within current authority or resources (including resources requested in the FY 1979 President's budget). These are either (a) directed specifically toward problem areas identified in the Inspector General's report, or (b) directed more broadly at controlling Medicare and Medicaid costs.

Reduction Goals (exclusive of cost)  
(Dollars in Millions)

	<u>FY 1979</u>	<u>FY 1980</u>	<u>FY 1981</u>
1. Ineligibility, errors, third-party liability...	\$272	\$538	\$797
2. Fraud and Abuse.....	99	116	127
3. Audit and cost reviews..	17	17	17
4. PSRO hospital review....	92	134	136
5. PSRO review of x-rays...	-0-	1	6
6. Lower limits for routine hospital costs (Section 223).....	50	50	50
7. Penalties in Medicaid...	-0-	252	375
Totals.....	<u>\$530</u>	<u>\$1,108</u>	<u>\$1,508</u>

Achievement of the first four of these objectives is already subject to Departmental monitoring under the Major Initiatives Tracking System. However, if there is any slippage in attaining these goals, it should be immediately noted and an analysis and action plan prepared to correct the situation.

Definitive data sources and indicators for measuring achievement of each of the above reduction goals and for tracking costs have not yet been developed. These should be submitted to the Assistant Secretary for Management and Budget by June 23, 1978. For the target related to unnecessary x-rays, HCFA should coordinate with PHS' plans for developing new standards for x-ray use.

The estimate for the impact of section 223 of P.L. 92-603 is tentative and will be revised based on the pending decision on what limits will be effective in July.

The 1979 budget assumed legislation imposing a penalty on States which failed to meet quality control targets. Currently, discussions are underway with States to develop improved quality control regulations which may replace the legislative proposal. This target will be revised when these negotiations are completed.

For the following areas, future targets depend on (a) the passage of authorizing legislation or, as applicable, (b) appropriation of funds for any necessary new resources. (Goals identified below are tentative savings, exclusive of costs.) For these items, plans are not required at this time. Once legislation is enacted or resources are appropriated HCFA should prepare plans in coordination with the Office of the Inspector General and the Assistant Secretary for Management and Budget.

- |  |                |                |                |
|--|----------------|----------------|----------------|
| 8. Hospital Cost Containment legislation-  | <u>FY 1979</u> | <u>FY 1980</u> | <u>FY 1981</u> |
| Effective date (Administration's bill) 10/1/78:  | \$730          | \$2,030        | \$3,760        |
| o The plan should specify data sources and indicators for measuring planned reductions. This target will be adjusted to reflect legislation finally enacted by Congress. |                |                |                |
- 
- |   |                |                |                |
|---|----------------|----------------|----------------|
| 9. Ancillary hospital costs -   | <u>FY 1979</u> | <u>FY 1980</u> | <u>FY 1981</u> |
| Pending legislation assumed effective 10/1/78.....  | \$40           | \$44           | \$48           |
| o Ancillary hospital costs (i.e., lab, x-ray) are those for which charges are customarily made in addition to routine service costs. The plan should include legislative proposals to be considered as part of the FY 1980 program. The effect on the target should be estimated. |                |                |                |
- 
- |   |                |                |                |
|---|----------------|----------------|----------------|
| 10. Renal dialysis -  | <u>FY 1979</u> | <u>FY 1980</u> | <u>FY 1981</u> |
| Recently passed legislation Requires Presidential signature effective date 10/1/78.....   | \$14           | \$40           | \$55           |
| o The plan for implementing this legislation should include (a) specific actions that will be taken to encourage an increase in home dialysis and (b) data sources and indicators that will be used for measuring reductions and related costs. |                |                |                |
- 
- |   |                |                |                |
|---|----------------|----------------|----------------|
| 11. Unnecessary beds -  | <u>FY 1979</u> | <u>FY 1980</u> | <u>FY 1981</u> |
| Pending legislation assumed effective 10/1/78.....  | -0-            | \$36           | \$112          |
| o The target assumes the passage of pending legislation which limits federal participation in capital expenditures, thereby restricting amounts spent for unnecessary beds. |                |                |                |

The target also includes new initiatives which would provide project grant support for converting or closing hospital beds, such as funds for retraining and meeting mortgage payments. The targets could vary, however, depending upon Congressional action with respect to legislation in this area and administrative steps taken within the Department. Thus, the plan should include:

- a. legislative proposals that should be considered as part of the FY 1980 program.
- b. a plan for coordination with the Health Resources Administration regarding their plans to reduce excess hospital beds.
- c. data sources and indicators HCFA will use in measuring planned reductions in Medicare and Medicaid expenditures for unnecessary hospital beds.

For the following areas, the Administration is currently developing proposed legislation. Once authorizing legislation is passed, HCFA should prepare plans to achieve the following reduction targets.

12. Common audit -	<u>FY 1979</u>	<u>FY 1980</u>	<u>FY 1981</u>
Proposed legislation. Department to transmit to Congress. OMB clearance received.....	\$41	\$41	\$41

- o The plan should specify data sources and indicators for measuring planned reductions and tracking related costs.

13. Provider Integrity -	<u>FY 1979</u>	<u>FY 1980</u>	<u>FY 1981</u>
Proposed legislation undergoing OMB clearance...	\$10	\$20	\$31

OMB is reviewing proposed legislation which would impose civil money penalties on fraudulent providers.

For the following areas, targets will be assigned at a later date, based on plans and decision papers which HCFA should submit to the Assistant Secretary for Management and Budget by June 23.

#### 14. Excessive nursing differential

- o Medicare currently pays 108.5 percent of the average hospital nursing care costs allocable to Medicare patients based on the presumption that elderly patients require more intensive nursing care than other patients.

An attempt by the Department to eliminate the differential was enjoined in a suit brought by the American Hospital Association (AHA) on the ground that the Department had not conducted sufficient study of the impact of withdrawing the differential. HCFA should submit an options paper which discusses the validity and size of the differential, legal issues, and the cost-benefit of new research.

15. Unnecessary surgery

- o A preliminary estimate indicates that 17% of all surgical procedures funded by Medicare and Medicaid are unnecessary. HCFA should submit a plan for (a) developing an adequate data base for estimating loss and measuring reductions in the rate of surgery for HCFA beneficiaries; and (b) developing indicators for measuring reductions in surgery rates for at least several specific procedures most likely to be performed unnecessarily as determined through PSRO reviews.

16. Unnecessary hospital stays due to inpatient surgery

- o Unnecessary hospital stays are directly affected by PSRO actions taken against unnecessary surgery in hospitals. HCFA should include its plan to reduce expenditures attributed to unnecessary hospital stays as part of its plan to reduce unnecessary surgery in general.

17. Additional reduction goals not included in any of the above that would complete a comprehensive HCFA plan to reduce waste, abuse, and fraud.

TARGETS TO REDUCE FRAUD, ABUSE AND WASTE  
PUBLIC HEALTH SERVICE

PHS Error Reduction Target

While the PHS is not being assigned a specific reduction target, PHS is responsible for taking the lead in developing action plans to achieve the following reductions and coordinating them with HCFA. (HCFA will include these reductions in its Medicaid and Medicare targets.)

Unnecessary Beds

- A reduction target of \$35 million in 1980 and \$112 million in 1981 has been assigned to HCFA, assuming passage by October 1, 1978 of the proposed grant program to assist hospitals to close or convert existing beds.
- No specific reduction targets are being assigned to reflect current initiatives in certificate-of-need reviews, reviews of capital expenditures under section 1122 (of the Social Security Act), and the impact of national planning guidelines or inter-Departmental agreements on reducing excess beds. These actions are geared to preventing further increases, but development of a method for measuring the impact of these initiatives is essential.
- By June 23 PHS should submit a plan with a specific time-table for:
  - continuing to track the number of excess beds in the country;
  - working with HCFA to track the impact of current and proposed initiatives to avoid additional or eliminate excess beds. (Each element should be separately tracked.)
  - recommendations for any further legislative proposals that should be considered as part of the FY 1980-1982 program.

Unnecessary X-rays

- FDA should develop a plan encompassing its existing initiatives to eliminate unneeded X-rays, which will result in a reduction target of \$1 million in 1980, and \$6 million in 1981 for Medicare and Medicaid.

- Achievement of the current reduction objectives is to be subject to monitoring under the Major Initiatives Tracking System, the vehicle currently used in the Department to monitor performance against specific objectives. However, if there is any slippage in attaining these goals, the Secretary and Assistant Secretary for Management and Budget should be immediately alerted and an analysis and action plan prepared to correct the situation.
- As part of its FY 1980-1982 budget program, PHS should submit decision papers outlining any new initiatives to make additional savings, but which require decisions concerning increased staffing.

#### Grant and Contract Procedures

Although the IG did not include this area in his First Annual Report, current audit activities indicate that research grants and contracts procedures are in need of review. PHS is in the process of developing an action plan to correct deficiencies in this area. This plan should concentrate on improving competition and avoiding conflict of interest in the grants and contracts awards process, and PHS should closely coordinate its activities with ongoing efforts of the Assistant Secretary for Management and Budget and the Office of General Counsel. The PHS action plan should also include an analysis of options regarding organization and procedural changes related to improving grants and contracting procedures.

# TARGETS TO REDUCE FRAUD, ABUSE, AND WASTE IN SOCIAL SECURITY

## AFDC and SSI Error Reduction Goals Which are Planned to be Achieved Within Existing Resources:

	<u>1979</u>	<u>1980</u>	<u>1981</u>
AFDC.....	\$ 89	\$110	\$123
Error target.....	7.3%	\$7.0%	6.9%
SSI.....	\$100	\$130	\$160
Error target.....	4.3%	3.9%	3.5%

Achievement of these objectives is already subject to the Major Initiatives Tracking System and the Department's cost saving monitoring efforts. However, if any slippage in attaining these goals becomes apparent, the Assistant Secretary for Management and Budget should be immediately alerted and an analysis and action plan prepared to correct the situation.

### Additional Efforts

A target is not being assigned at this time to achieve additional AFDC savings based on the proposed management initiatives and impact of pending legislation you identified. SSA should prepare for review a more complete analysis and action plan for each proposed initiative and legislative option:

- include in your analysis net savings resulting from legislation
  - .. providing incentives to States to expand their use of ADP systems and the impact of the proposed legislation to standardize the work expense rules.
- your plans for improving AFDC program operations should be developed with the objective of achieving at least a five percent payment error rate by 1981.

A specific cost savings target will not be assigned for social security payments until better data are available which isolate the degree of error and the factors which cause it. SSA's plan to establish new Title II quality assurance systems must be maintained on schedule and the Assistant Secretary for Management and Budget should be kept fully informed of all progress. In the interim SSA should provide (1) an analysis of identified overpayments which are not recovered by SSA and (2) include in its 1980 budget submission, options and resource requirements for expanding quality control activities in other known error prone processes--e.g., expanded initial disability claims reviews and continuing disability investigations.

TARGETS TO REDUCE FRAUD, ABUSE, AND WASTE IN  
OFFICE OF EDUCATION PROGRAMS

Achieve the following minimum reduction goals given  
current law and resources:

	(dollars in millions)		
	<u>FY 1979</u>	<u>FY 1980</u>	<u>FY 1981</u>
Student Financial			
Assistance.....	\$284	\$320	\$345
Title I ESEA.....	22	34	34
Total Reduction....	<u>\$306</u>	<u>\$354</u>	<u>\$379</u>

The action plan for reducing fraud, abuse and waste in education programs should include:

- o A timetable for completing the major action steps required to achieve these reductions. This timetable should incorporate activities for existing initiatives in student aid.
- o A definition of the measures that OE will use to gauge progress against the targeted reductions and quarterly targets of performance using those measures.
- o A description of any other ongoing initiatives to avoid waste.
- o A decision paper which outlines in detail, alternative ways for eliminating the backlog of defaulted Guaranteed and Direct Loans over a four to five-year period. Include a description of the additional resource requirements under each alternative, along with an analysis of the expected results of those additional resources.
- o Additional reductions should be identified based on enactment of pending legislation for Title I ESEA which would increase funds for State administration which could be used for monitoring, auditing, and other compliance activities.
- o Briefing papers describing any other new initiatives for reducing fraud, abuse, and waste, including plans to implement the new activities. These plans should include a description of additional resource requirements and an analysis of their impact on the problem areas.



TARGETS TO REDUCE FRAUD, ABUSE, AND WASTE IN  
ADMINISTRATIVE AND SUPPORT COSTS

The action plan for eliminating unreasonable administrative and support costs (indirect costs) should include:

- o Improved approaches for estimating: 1) total indirect cost reimbursements (i.e., in contracts and discretionary and formula grants); and 2) the size of unreasonable indirect costs.
- o A commitment to achieving the following reductions which are minimum goals given current law and resources.

	(dollars in millions)		
	<u>FY 1979</u>	<u>FY 1980</u>	<u>FY 1981</u>
Reductions in			
Indirect Costs.....	\$15	\$16	\$17

- o A timetable for completing the major action steps required to achieve these reductions.
- o A definition of any measures, besides disallowances, which will be used to gauge progress against eliminating unreasonable indirect costs, and quarterly targets of performance, using disallowances and these other measures.
- o Costs associated with major action steps.
- o A brief discussion of how the goals relate to the Major Initiatives Tracking System.
- o Decision papers detailing any new resources the Assistant Secretary for Management and Budget needs to do a better job in eliminating unreasonable indirect costs, along with an analysis of the expected results these additional resources will produce.

TARGETS TO REDUCE FRAUD, ABUSE, AND WASTE BY  
CONDUCTING MORE INTENSIVE AUDITS AND FINANCIAL REVIEWS

The action plan for conducting more intensive audits and financial reviews should include:

- o A commitment to achieving the following reductions which are minimum goals given current law and resources.

	(dollars in millions)		
	<u>FY 1979</u>	<u>FY 1980</u>	<u>FY 1981</u>
Increased Audits and Financial Reviews..	\$15	\$30	\$30
✓ AFDC Fraud and Abuse.	\$12	\$12	\$12
Medicare/Medicaid Fraud and Abuse....	<u>\$10</u>	<u>\$15</u>	<u>\$20</u>
Total	\$37	\$57	\$62

- o A timetable for completing the major action steps required to achieve these reductions.
- o ~~Decision papers detailing:~~ 1) how the Department might reallocate its existing resources to increase the impact of its audit and financial review efforts; and 2) ~~the new resources~~ the Inspector General needs to do a better job in fighting fraud, abuse, and waste, along with an analysis of the expected results the IG will achieve with these additional resources.

Mr. MORRIS. In our next annual report we will attempt to review in retrospect the value and uses of this type of inventory and the progress made by the Department in acting on its findings.

As we wrote the committee staff on May 11, we expect continuing congressional, GAO and departmental studies to reveal some other areas of potential savings. A prime illustration is the current plan to apply quality control measures to social security payments systems, starting this fall.

The second subject of our report concerns the Audit Agency. Its biggest challenge is how to cope with a workload of over 50,000 auditable entities—that is all of the grantees and recipients of HEW funds that need to be audited—and how to follow up on actions taken on past audits. Over 6,700 audits were processed last year. That number will grow in the future.

Third, we discuss the Office of Investigations, which has experienced continued workload growth and increased results have ensued from its efforts. Nothing less than a 100-percent increase in its professional staff, in our judgment will be adequate to cope with a workload which now totals about 1,000 cases. The report describes some 113 convictions resulting from HEW investigative efforts, including the Office of Investigations and the Health Care Financing Administration, in 1977—the majority of these being in the health field.

Further, the report deals with our special initiatives, which we will discuss later. They have been aimed in the first year in the following areas: First, health care, particularly the medicaid claims payment area; second, public assistance payments under AFDC; third, student financial assistance; and fourth, contracts, grants and code of conduct matters.

We expect these areas to continue to consume the major part of our new initiatives in the current calendar year.

Last, the report makes 18 recommendations, six of which suggest additional statutory authority which would prove beneficial. These are enumerated in attachment 1 to this statement, and two others are discussed in the statement on page 16.

Now I would like to mention briefly projects integrity and match and to ask the question: "are they cost effective?"

Senator NUNN. We will have all of your attachments as part of the record here, without objection.

Mr. MORRIS. Yes, sir. Thank you.

[The attachments follow:]

#### ATTACHMENT 1

##### SUMMARY OF RECOMMENDATIONS TO ENHANCE THE EFFECTIVENESS OF HEW EFFORTS TO COMBAT FRAUD, ABUSE, AND WASTE

(Articles with asterisks require statutory action)

1. The OIG should conduct a periodic inventory of "best estimates." Continuing efforts should be made to expand and sharpen these estimates and to seek more scientific measurement techniques.

2. The losses due to management and systems deficiencies appear to receive too little attention in terms of staff resources applied. A study of the implications of this and recommendations for action will be a continuing OIG objective.

It is believed that tighter "front-end" controls over eligibility determination and claims payment procedures, simpler reimbursement techniques, and higher standards of integrity on the part of all concerned are essential to such improvements.

3. Ultimately, an additional 1,382 staff-years may be required to enable the Audit Agency to give timely attention to its total workload. In the meantime, augmentation by 60 staff-years of contract support, and 60 in-house personnel, will permit the present level of effort to continue, including about 120 staff-years devoted to fraud and abuse initiatives. This is presented in the FY 1979 budget.

4. Continuing attention to reducing the number of unresolved audit reports, and associated dollars, is imperative.

5. Our analysis of the handling of cases referred to the Department of Justice reveals an average of 2.5 months between referral and indictment, in those cases where indictments are returned; and an average of 1.5 months between referral and declination for OI cases and 5 months for OPI cases. It is apparent that more uniform and reliable systems of reporting and collating these data are needed for the future. However, we are pleased with the response of the U.S. Attorneys—and of headquarters officials of the Justice Department, both in the Civil and Criminal Divisions—during the past year.

6. OI should gradually relieve OPI of responsibility for Medicare and Medicaid fraud investigations as expansion of the OI staff permits. Joint planning of this transition is essential.

7. Project Integrity should continue as a series of national health care initiatives, conducted as a partnership between HEW and the States. The States should participate in planning future initiatives at an earlier point. The pattern of resistance by the nursing homes in permitting HEW access to records is noted and Congress will be kept informed.

8. The Office of Investigations (OIG) and the Office of Program Integrity (HCFA) witnessed a successful year of convictions resulting from their investigations—a total of 113. In addition, the States reported 129, and the FBI 23. The immediate problem is a caseload of 1,349 cases, of which OI has full responsibility for 538; OPI for 313 (36 cases are being worked jointly with OI), BSFA for 23, and the States under OI/OPI monitorship for 475 Project Integrity cases. We have concluded that OI must double its staff (from 114 to 214) to cope with this load. This is provided in the FY 1979 budget. We will assist in evaluating related staffing needs of other HEW components in the future, especially OPI and BSFA.

\*9. A "Civil Money Penalties Bill" is essential to permit more effective civil sanctions against those who defraud the health care programs.

\*10. Congress should clarify the intent of the "Free Choice of Provider" provision in respect to competitive procurement of laboratory services, medical appliances and accessories—and perhaps of other supporting services of a non-personal nature.

11. Project Match initiatives should be expanded and conducted on a regular recurring basis. Delays now being experienced in obtaining timely permission to match Civil Service and Department of Defense tapes are noted on page 51 of the Annual Report. These may be overcome when guidelines, now in preparation, are promulgated. The Deputy Inspector General is participating in drafting these guidelines.

\*12. Congress may wish to endorse a regular program of matching State welfare rolls against other files—including Federal military and civilian employees, private employer wage reports, State employees, Child Support Enforcement, mortality data, SSI files, and SSA (Title II) benefits payments files. This would expand upon the policy established in Section 411 of P. L. 95-216 in respect to wage data exchanges.

\*13. The Office of Family Assistance needs a significantly larger staff to carry out an adequate program of training and technical assistance to support State programs for reducing fraud, abuse, and waste. In this connection Congress should extend to State AFDC programs the same statutory funding benefits that are now available to States under the Medicaid program for (1) developing and operating management information systems, and (2) establishing fraud control units.

\*This requires statutory action.

\*14. To support the accelerated collection effort of the Bureau of Financial Assistance, authority to utilize IRS address data in the National Direct Student Loan collection effort would be highly beneficial. H.R. 8746, now pending, would permit this.

\*15. Congress may wish to state, as national policy, the desirability of matching Student Financial Assistance default files—Federal and State—against public payrolls, both Federal (including military) and State.

16. More attention is needed to the education of employees and managers on the cause and prevention of code-of-conduct violations and conflicts-of-interest. This should be a joint initiative between the Assistant Secretary for Personnel Administration and the Office of Inspector General.

17. The OIG should continue joint initiatives with the Assistant Secretary for Management and Budget in upgrading the professionalism of contracts and grants managers.

18. The OIG's new "Early Review" service to colleges and universities should improve accounting and reporting systems required to support performance under Federal research grants and contracts. Prompt penalties should be applied in those instances where institutions do not meet adequate standards.

#### ATTACHMENT 2

##### CASELOAD IN OFFICE OF INVESTIGATIONS BY PROGRAM OPERATING COMPONENT AS OF JUNE 30, 1978

Principal operation component	Pending active	Pending inactive	Total
Office of Education.....	109	69	178
Health.....	32	6	38
Office of Human Development.....	8	0	8
Social Security Administration.....	39	9	48
Office of the Secretary.....	17	1	18
Health Care Financing Administration.....	123	20	143
Subtotal.....	328	105	433
Project Integrity.....	56	445	501
Project Match.....	23	0	23
Total.....	407	550	957
Average man-days estimated for completion of each pending active case in 10 regions.....			59.5
Average man-days estimated for completion of each Project Integrity case.....			44.1
Average man-days estimated for completion of each Project Match case.....			20
Estimated man-days for completion of all pending active cases in 10 regions.....			24,220

1 119.9 man-years.

Mr. MORRIS. We believe that a primary value of our office lies in its ability to pioneer new efforts, working in partnership with the responsible HEW officials, as well as with other Federal and State agencies. Some of these new initiatives will be more successful than others since most are experimental and are being done for the first time. The real test of their value is whether we and the States learn new ways of detecting and preventing fraud and abuse, and apply these findings to conserving the resources expended.

I would like to discuss briefly our two major initiatives known as Project Integrity and Project Match.

First, Project Integrity, which began one year ago, is in midstream. It is an effort to spotlight abuses by physicians and pharmacists in every medicaid State, plus Puerto Rico and the District of Columbia. Out of 2,458 cases selected for intensive review, the scorecard as of July 14 was as follows:

—517 cases have been selected for full field investigations, meaning that they represent potential criminal violations. To date there have been—one more was added yesterday—a total of 13 indictments. of

\*This requires statutory action.

which 4 have gone to convictions so far. Our best judgment is that another 160 cases will prove to have prosecutive merit.

—Then there are 605 cases that were chosen for recoveries or administrative sanctions. Thus far, claims for restitution in excess of \$2.6 million—we added another \$500,000 yesterday—have been initiated by the States.

Third, there are 519 cases still under preliminary review to ascertain in which category they will fall.

Finally, we found 817 cases which have been closed, warranting no action.

The problems being encountered are very familiar to this committee. They consist of false claims for services not rendered, inflated billings, substitution of generic for brand name drugs, over-billing for laboratory services, as well as, simply, erroneous billings.

The cost of this project at the Federal level, is estimated to be \$8.2 million when fully completed. We believe that if we break even on our direct costs for this type of effort, obtain a sizable number of indictments and convictions and, in addition, have a profitable learning experience in most of the States, the project will be highly cost-effective.

However, we have also concluded that such nationwide efforts are very difficult to manage effectively when the work stretches out over a period of 1 to 2 years. We are depending on a work force nationwide of between 350 to 500 Federal and State personnel.

This level of effort becomes extremely difficult to sustain over a long period. Hence we are planning the next series of Project Integrity initiatives, with respect to areas in dentistry and laboratories, around an intensive effort in a few States having a high degree of interest or expertise in the specific subject.

We are now discussing this approach with selected States and are encouraged by the response. If this approach succeeds, we now plan to continue such initiatives over the next 2 to 3 years and to cover systematically each of the major segments of the health care field. This will enable us to test the most effective techniques of detecting fraud, abuse, and waste, including, where applicable, computer screening techniques. Research is being conducted on outpatient services, medical supplies and equipment, transportation, other practitioners, nursing homes and hospitals.

Our second major effort is called Project Match. This project is designed to check the Federal payroll, both military and civilian, for those who may be abusing federally-financed welfare and student aid programs. Two principal efforts have been initiated and others are in the research stage.

First is the computer match of Federal employees, some 4.8 million names, against the AFDC rolls in 26 jurisdictions, representing 78 percent of welfare recipients. This resulted in identifying over 30,000 cases of potential abuse. We expect that about 4 out of 5 will be found to be eligible or not a problem. Those found to be ineligible or overpaid will be adjusted and funds recovered where applicable. Those who have a high criminal potential will be turned over to U.S. attorneys for possible prosecution.

This is a very time-consuming effort since it involves participation by numerous Federal agencies, by the State welfare agencies, and by the U.S. attorneys and the FBI.

Senator NUNN. Mr. Morris, what kind of cooperation are you getting from the Justice Department on prosecutions? Do you have a good working relationship? If so, at what level of the Justice Department?

Mr. MORRIS. Sir, we have a splendid relationship. It began before I took office, as a matter of fact, with the Criminal Division, working with the present Deputy Attorney General, and the head of the Criminal Fraud Section.

We are working with them on a day-to-day basis. Mr. Ruff knows that area well. He might want to amplify on this if you would like to pursue it.

Senator NUNN. Mr. Ruff?

Mr. RUFF. Senator, I think it is fair to say that we have had excellent support, particularly from the Fraud Section of the Criminal Division and from the civil counterpart of that section as well, not only support for individual cases as they develop but real interest in trying to work with us on some of these projects and on some broader attempts to get at the detection of fraud and do something about it.

I might say, too, that the U.S. attorneys' White Collar Crime Committee has met with me and with the Assistant Inspector General for Investigations to try and ensure that the U.S. attorneys offices around the country are appropriately responsive to HEW's concerns.

Senator NUNN. Thank you.

Mr. MORRIS. Our estimated cost to complete this phase of Project Match is about \$1 million. This is a much less expensive program. This amount has already been saved in actions to date, we believe.

We are projecting total Federal savings of \$5 to \$6 million, based on removing ineligible from the rolls and reducing overpayments.

We have recently invited all other States to join this project. Of the remaining 26, 20 have thus far submitted their data to us.

Senator NUNN. Is that \$5 to \$6 million a total lifetime cost or a 1-year cost?

Mr. MORRIS. That is a 1-year cost, so in effect it is a recurring cost, potentially, over many years.

Senator NUNN. Are you saying that on this particular program you expect to save five to six times as much as it cost in the first year?

Mr. MORRIS. Our direct cost, yes, sir. That does not include State costs.

One of the interesting byproducts of this experiment is the ability to match each State against each other State in search of double-dippers. In 26 jurisdictions checked, over 9,000 cases of potential duplication were identified. We are still in an early phase of testing this technique but believe that this match can be made efficiently and at a low cost at the Federal level, perhaps once each year.

Another match of the Federal payrolls has been made against the default file of the guaranteed student loan program. The 6,783 Federal matches were identified, including HEW, and are being

actively followed up for collection. It is expected that a high percentage will be returned to repayment status. This is part of a nationwide effort by the Office of Education to attack the large backlog of defaulted loans.

We are continuing to work on a variety of match-type projects. One will be a match of Federal employment, both military and civilian, against the supplemental security income files. Another is the service being rendered by Social Security to interested States in matching wage data versus AFDC rolls, as authorized by Congress in section 411 of last year's social security amendments.

Senator NUNN. On that point, I was, along with Senator Long and several others, an author of the Runaway Fathers bill. Is that what you are talking about?

Mr. MORRIS. Sir, that is another program, the child support program. We are working on that part with social security.

Senator NUNN. This is a different program you are describing here from that Runaway Fathers bill?

Mr. MORRIS. Yes, sir.

Senator NUNN. What jurisdiction do you have over the Runaway Fathers legislation in your department?

Mr. MORRIS. Only the kind of jurisdiction we enjoy with respect to all programs under our laws, which is to work with them and coordinate their efforts, as appropriate, within the department and with other agencies.

The child support program is very active and vigorous from what I have seen of it. We have not spent as much time with them so far as we have with some of the others I am describing.

Senator NUNN. Then that is being handled at the program level and not the Inspector General level.

Mr. MORRIS. Yes, sir.

Senator NUNN. Secretary Califano made a report on that yesterday and estimated a half billion dollars in savings per year.

Mr. MORRIS. Yes, sir.

A third experiment we are beginning is that of matching death tapes from selected States against various payment files, such as again social security, SSI, and medicare.

On the whole, we believe these initiatives have demonstrated their value and should be continued. Among the suggested legislative initiatives which appear in attachment 1 are three which bear upon this matter.

[At this point Senator Percy entered the hearing room.]

Mr. MORRIS. Turning now to our workloads and backlogs. We reported to Congress in our third quarterly report that the Office of Inspector General has been unable to achieve its authorized strength of 1,064 positions during this fiscal year because of insufficient funding. Hence, we have been unable to fill 90 vacancies which have been approved by Congress.

At the same time we have applied substantial AA and OI resources to the new initiatives described above—in fact, well over 150 staff-years—which had not been contemplated in the original budget. Thus we now have rather excessive backlogs which we cannot continue to tolerate. If our 1979 budget is approved, however, it will enable us



to manage this workload adequately and to continue the special initiatives.

Briefly, the Office of Investigations, as of June 30, had 957 cases on hand which will require 120 staff-years to complete. That analysis appears on the last page of our statement.

Under today's authorization we have 77-field staff available to work these cases, including those assigned to Project Integrity and Project Match. Hence, there is approximately a 2-year backlog of case work as of today.

Senator NUNN. Let me ask you this: You say you have 1,064 positions during this fiscal year that you have been unable to fill because of insufficient funding. Yet you say the Congress has approved this.

Mr. MORRIS. Yes, sir.

Senator NUNN. Where is the block in the funding?

Mr. MORRIS. Let me expand on that. The authorized strength is 1,064. There are 90 vacancies out of that number which we have been unable to fill because money was not available. The budget for this year was made up long before we were created. The Office of Budget simply underestimated our needs. There is nothing we could do about it this year except ask for supplemental moneys. We have done that and are hoping to get some relief in the last months of the fiscal year.

Senator NUNN. Do you have enough money in this year's budget?

Mr. MORRIS. The budget is fully adequate if approved.

Senator NUNN. Would you keep us informed if there is any hitch along the way?

Mr. MORRIS. We would be delighted to do so.

Senator JAVITS. While there is a little interruption, might I say to both of these gentlemen how much I appreciate this work. Also, I have been thumbing through your testimony, because I have to go elsewhere shortly. I see one thing here that we ought to look into which relates to the practice of hospitals dealing with medical residents and the possible diversion of what are medicare fees essentially. I will have our staff in Human Resources dig into that.

Mr. MORRIS. Very good, sir.

Senator JAVITS. If you would be kind enough to cooperate and if you will refer the necessary materials.

Mr. MORRIS. Very good, sir.

Mr. RUFF. Fine.

Senator JAVITS. Thank you, Mr. Chairman.

Mr. MORRIS. For the Investigations Office, the 1979 budget will enable this professional staff to increase to 160, or a 100-percent increase. If 120 spaces are devoted to reducing the present backlog to a 12-month basis, 40 staff could be allocated to new work. We think this is a sound objective.

We are planning to devote this staff to assuming the large criminal caseload which up to the present has been performed by the Health Care Financing Administration. Arrangements to take over that load have already been consummated.

Looking at the Audit Agency for a moment, for the past several years the Audit Agency has projected its total annual requirements to cover some 50,000 auditable entities. Its workload status versus the

staff needed is shown by the table I have outlined in my prepared statement. I won't read the table except the bottom line which says they need an additional 1,382 staff in addition to the 900 currently authorized if they are to do an optimum job.

[At this point Senator Sasser entered the hearing room.]

Mr. MORRIS. The analysis illustrates that the Agency has long been in a deficit position.

The new demands to support investigations and to provide leadership for Project Integrity and Project Match have placed a further drain on its resources of over 120 staff-years. This too must be added to the basic deficit of 1,382.

To compensate for the additional drain, we have requested, in the fiscal year 1979 budget, funds to contract for 60 staff-years of support from State audit agencies and CPA's, plus internal growth of 60 staff-years.

If we are unable to obtain that support, it will become necessary to reduce the time devoted to special initiatives and criminal investigation activities.

[At this point Senator Javits withdrew from the hearing room.]

Mr. MORRIS. We believe this would be unfortunate. Financial analysis expertise is essential to many white-collar crime investigations. Furthermore, this expanded role for the Audit Agency as a part of the Office of Inspector General is one that the auditors have responded to with creativity and innovation, and it is increasing the Audit Agency's capability to identify fraud and abuse in HEW programs as part of its regular audit effort.

Now we would like to turn in the remainder of our statement to several special questions and issues. One deals with cases where the conduct is wrong but not prosecutable. Another is the teaching hospital problem. A third is the effectiveness of HEW components in recovering funds improperly applied as revealed by audits. Another is the FOIA and Privacy Act experience. Still another is experience with our subpoena authority. Finally we will discuss our role in establishing medicaid anti-fraud units authorized by last year's legislation.

Turning first to cases where the conduct is wrong but not prosecutable.

On the whole, it is fair to say that existing statutes provide an adequate basis for prosecution of fraud on HEW programs. Difficulties in developing cases and securing convictions more often involve problems of proof, particularly of the intent to defraud, or of credibility, than the code's failure to make wrongful conduct criminal.

Nor can the special difficulty involved in the prosecution of physicians, school officials, and similar defendants be ignored—the difficulty of convincing jurors that seemingly upstanding members of the community have, in fact, violated the law.

One characteristic of fraud prosecutions involving HEW and similar programs is the important role played by the regulations governing the administration of the program and the interpretation of those regulations by the agencies charged with implementing them. This is an issue of continuing concern to our Office and one on which

we regularly work both in the Department and with the U.S. attorneys and the program agencies.

In two areas we have encountered substantial difficulty which can only be remedied by legislative action. First, because both the medicare and medicaid programs rely heavily on non-Federal administrators—carriers and intermediaries in medicare and State agencies and fiscal agents in medicaid—they risk subversion by those who seek to exercise improper influence over crucial claims-payment and other funding decisions.

Under present law, one who gives something of value to a medicare carrier employee or a State medicaid official, neither of whom is a Federal public official, has not violated the Federal bribery statute. Indeed, although most States have their own bribery laws that would cover the latter cases, the former might not violate any criminal statute.

It may be possible to charge the briber of the carrier employee with fraud against the Government if he uses the mails, but prosecution need not rest on so uncertain a base. It would seem appropriate for the Congress to enact legislation making it a Federal offense to pay something of value to a carrier, intermediary, State or fiscal agent with the intent to influence his action in connection with either the medicare or medicaid programs.

And it is the Federal Government that has the primary interest in their prosecution. We should not have to rely on the vagaries of local law enforcement and State statutes when the basis for Federal jurisdiction seems clearly to be present.

We would suggest that the Congress give consideration, therefore, to enacting legislation which would make it a Federal crime to embezzle or otherwise criminally convert Federal grant, contract, or other assistance funds. In this regard it is noteworthy that similar provisions already cover certain Federal grants and are continued or expanded in proposed section 1731 of the Criminal Code Reform Act.

Senator NUNN. In this particular respect, does that act go far enough as it is now written?

Mr. RUFF. If I may respond to that, Senator. Section 1731 as it is presently drafted deals with some very specific grants; for example, covering the Law Enforcement Assistance Administration and other special agencies, and does not reach out and cover broadly the grants coming in from all Federal agencies to State and/or private recipients.

Now our suggestion really is that we could badly use here a broader statute that would cover all grants made by all Federal agencies.

Senator NUNN. My only question here—and I agree with your general recommendation—is how you draw the line. The Federal Government has so permeated every State and local government in terms of funds that virtually no one working for the State, city, or a local government isn't in some way either directly or indirectly involved or a recipient of Federal funds. Are we endangering that if we make that kind of extension, basically extending the Federal arm of law enforcement into every facet of life?

Mr. RUFF. I think it is a serious concern, Senator. I think a statute could be drafted that would be sufficiently narrow to reach not the broad Federal funding of programs like AFDC or other general support for the State and local governments but, rather, the specific grant to a school or a head start organization, whatever it may be, that is identifiable and goes in and is used by the specific recipient. It is that kind of situation we really have in mind.

Senator NUNN. Would you furnish to us at your convenience, Mr. Ruff, a proposal that would be drawn that narrowly? Knowing your background in this area, would you anticipate the philosophical arguments here and give us some kind of a pro-con summary as you see it? I know you can probably do that as well as anybody.

Mr. RUFF. Thank you, Senator.

Senator NUNN. I am not asking for a 100-page report but just a short point paper on this.

Mr. RUFF. I will try to keep it under 75 pages. [Laughter.]

Senator NUNN. Right.

[The document referred to in the preceding colloquy had not been made available to the subcommittee as a public document at the time of publication. When it is received as a public document it will be included in the files of the subcommittee.]

Mr. MORRIS. The second issue is the teaching hospital problem. In the nature of the medicare and medicaid programs, the line between abusive and fraudulent conduct may sometimes be a thin one. An area that has become a matter of concern to our Office in recent months is the practice of billing by teaching hospital staffs for patient services.

Under part B of medicare, attending physicians submit bills for surgery or medical care provided patients whose care is the primary responsibility of salaried residents and interns—salaries which already are paid for under part A as part of the hospital's cost base.

Under certain circumstances, this kind of billing is perfectly proper, but there has been an increasing tendency for the teaching physician to charge for patient care when he, in fact, has performed no service at all.

Although the legislative and regulatory picture over the last several years has been uncertain in some respects, existing rules make it clear that a physician who has general supervisory responsibility over a resident may not, for example, bill medicare for visits to the patient, et cetera, when the resident or intern actually sees the patient instead of the teaching physician.

We have at the present time a number of matters of this type under inquiry, through both the Office of Investigations and the Audit Agency. There is some indication that hospitals may be using part B funds to provide money for research and other institutional purposes that cannot be supported by normal revenues or by research grants and contracts.

There is also some indication that post-residency fellows are being retained for additional training, with their salaries paid out of money received through medicare and medicaid claims for their services, and the excess funneled into either institutional or private coffers.

We cannot begin to predict whether any of these matters will result

in criminal action, but we do intend to explore carefully the manner in which medicare and medicaid claims processes operate in this area, and to make recommendations to the appropriate program agencies concerning both the recovery of improperly paid claims and the improvement of systems management.

The third area is dollar collections under our audit findings. During the past 3 fiscal years, our audit reports have questioned between \$165 million and \$194 million per year. Experience has shown that in most cases, these amounts were questioned because there was a lack of documentation to support a finding that they were disbursed for the purpose authorized or were incorrectly determined based on rates or terms authorized by the covering instrument.

During this same time period, the principal operating components [POC's], which is the name we give our program agencies, concurred in questioned costs of \$69 million to \$107 million.

For fiscal year 1978 we estimate that questioned costs will amount to about \$200 million and that the POC's will concur in about \$78 million. I might point out that POC concurrences in any one fiscal year do not necessarily relate to questioned costs for that year, for many of the reports resolved may be carried over from a previous year.

When a POC concurs in questioned costs, it means that they have agreed to initiate collection action for the amount involved—actual cash recovery, correction of expenditure reports, offset against future funding or other adjustments.

Our previous reviews in this area disclosed that the POC's, although they concurred with the recommended audit disallowances, did not always take aggressive recovery action. To remedy this situation, we worked with the Deputy Assistant Secretary of Finance to develop a system to "Control and Account for Audit Disallowances."

The key ingredient of this system is to establish an accounts receivable when the POC's have stated their intent to obtain appropriate financial adjustments. The system, which went into operation around June 1977, has been through the shakedown period. We are now evaluating the procedures for each POC to determine (1) if they are effective; and (2) the actual amount of financial adjustments. Our first review began May 1978. The results will be known around January. We will be glad to advise the committee of the facts as soon as they are available.

A fourth issue is the Freedom of Information Act matters. Historically, final reports of the Audit Agency have been available to the press or the public on request, except for portions that may contain confidential or trade secret information, and we have continued that practice.

Similarly, we have released all or portions of various studies conducted for the Secretary where release would not jeopardize a criminal action and would not infringe the privacy interests of those involved.

Of particular concern, however, has been the increasing number of requests for information in our criminal investigative files. In 1977, the Office of Investigations handled 13 such requests at an estimated

cost of \$25,000. In the first 6 months of 1978 alone that office has processed 24 requests at an estimated cost of over \$40,000.

Expanded access to criminal investigative files, even after an investigation is closed, if required, could create a serious risk of invasion of privacy, not only for the subjects of the investigation but for those who give information to investigators.

Senator NUNN. In other words, what you are saying is, we are running into the possibility and probability here of conflicts between the goals of the right of privacy and those of the Freedom of Information Act.

Mr. MORRIS. We are concerned with that danger, Senator. That is the reason for this.

Senator NUNN. I am also concerned with this overall subject. I do not in any way pretend to have an answer to it. I think that in the effort to enact very fine legislation on the right of privacy and Freedom of Information Act, the purpose of which was noble in both cases, we may have swung the pendulum so far that we are making Government inoperable. We are also creating some conflicts between the two.

We are going to be getting into this in terms of its effect on criminal law enforcement to a considerable degree. If you think you are frustrated right now, the FBI spends more manpower and money on answering Freedom of Information requests and Privacy Act requests than they do on fighting organized crime in the entire United States. Now something has gotten out of whack.

So we are going to be looking into this not with the idea of repealing these laws, but with the idea of trying to tailor them to other legitimate concerns. Any suggestions you might have along this line as affects your operation we would be most receptive to.

Mr. MORRIS. We would be very pleased to cooperate, sir.

I would want to stress that what we are talking about here, as shown in the last paragraph on page 23, is our concern for the future. Those within the Department with responsibility for administration of the Freedom of Information Act believe the exemptions covering investigative activities will prove adequate to prevent any injury to our office and its functions.

Of course, we will always be appropriately responsive to legitimate public concerns. Thus we have pursued in the past, and will continue to pursue in the future, a policy of disclosing as much information about our activities as we can without violating the rights of those whose names appear in our files and without seriously undermining our ability to combat fraud in HEW programs.

Next we address the use of subpoenas. One of the unique features of our enabling legislation is the provision granting authority for the issuance of subpoenas. We have used the subpoena power only sparingly in our first year—initially in connection with a nursing home audit where the recipient complied, and recently in connection with an ongoing criminal investigation where we sought records from two corporations and from the banks where those corporations had their accounts. [Enforcement action may be required in some or all of these latter cases.]

Although the statute is not entirely clear on the point, we have interpreted it to mean that the subpoena extended only to books, records, and other documentary evidence, but we have found this limitation of no great concern.

Although we plan to exercise our subpoena power selectively and to scrutinize carefully requests from our field offices for its use, we do view the authority as an important adjunct to our investigative and audit functions. In many criminal investigations, we will have available the vehicle of the grand jury subpoena to obtain documentary evidence, but the administrative subpoena has the advantage of being returnable at times when the grand jury is not sitting and the advantage of avoiding the severe restriction of the grand jury secrecy rules.

Further, there will be occasions, as we have already discovered, when access to records in noncriminal inquiries is necessary, and for this purpose the administrative subpoena will prove an invaluable tool.

As to section 17, Anti-Fraud Units, among the many innovative provisions of Public Law 95-142, which passed last October, one of the most important was the authorization for 90 percent Federal matching of State expenditures to create and operate medicaid fraud control units.

We have worked closely with the Office of Program Integrity of the Health Care Financing Administration, both in preparing the implementing regulations and in the subsequent processing of the State applications for certification. To date, 5 State units have actually been certified and 17 more are in one stage or another of departmental review.

The legislation was modeled, in large part, on the office of the special prosecutor for nursing homes in New York, and in drafting the regulations we demonstrated a strong preference for placing the unit in the State Attorney General's office or in some comparable central location.

It was our belief that the purposes of the Act could best be met by developing a central body of investigative, auditing, and prosecutorial expertise which would continue to function even after the end of the Federal 90 percent matching period in September 1980.

Most States which have so far made application have structured their units along these lines, even where some considerable realignment of jurisdiction was required, and we are optimistic that we will have before the end of this year as many as 25 or 30 units in place.

We anticipate that the presence of these units in the major medicaid States will substantially enhance the national effort against fraud by health care providers. Many units have taken, or will take, responsibility for the pursuit of cases developed under Project Integrity, and we expect that they will assume a large part of the responsibility for prosecution of cases arising out of our ongoing efforts to implement other computerized fraud detection programs.

Of course, the Federal Government will continue to play a major enforcement role. We expect that the U.S. attorneys will become actively involved in these medicaid fraud cases of special complexity

or significance, particularly those having multi-State or national implications.

Our office has principal responsibility for liaison with the State units and for assuring that there is an appropriate sharing of information and resources among the State and Federal agencies. We also have the lead responsibility for developing training programs for the unit staffs and have begun planning for the first national seminar in the fall.

In conclusion, we recently testified before the Subcommittee on Governmental Efficiency at a hearing chaired by Senator Eagleton, on the Inspector General legislation known as H.R. 8588. We expressed the view that the bill as it has passed the House would not impair our operations, even though it makes several changes in the authorities and requirements placed upon our office.

In fact, we feel that the semiannual reporting provision is an improvement over our statute which requires four quarterly reports plus an annual report. We also believe that granting the Secretary 30 days to review and comment on such reports is desirable.

As we testified before Senator Eagleton, the mixing of three kinds of skills in one office—audit, investigative, and systems improvements—enhances the effectiveness of all three.

We are also very sensitive to the view of the Comptroller General that the integrity and independence of the audit staff must be preserved and must not be subordinated to the investigative activity. We think our current budget for audit time to be devoted to fraud and abuse—approximately 15 to 20 percent—is an acceptable and beneficial mix.

Senator PERCY. Could I ask a question? Were you able to put equal emphasis upon audit, investigations, and systems improvement? Are all three of comparable priority? Your office is a new one and has traditionally been looked upon as an audit office. But from our standpoint, I think both Senator Nunn and I would feel that investigative and systems improvement are of equal importance. That is the creative end which we were hoping for. I would hope that in 15 months now you have been able to put equal emphasis on that.

Mr. MORRIS. Sir, these three units have each their own status directly under Mr. Ruff and myself. The audit system is quite large and quite mature. The investigations office was tiny when we took it over. It is growing rapidly. We know it must be an organization of substantial size. Systems will always be small. We have about 15 professionals now. We think we need about 30. These are experts in programs and computer technology and the special skills we need available to work either with audits or investigations. The mix we think is quite good.

Senator PERCY. Thank you.

Mr. MORRIS. Senator, we believe the creation of a highly professional office of investigations, including the use of both skilled investigators and attorneys with experience in the development and prosecution of white collar crime, is essential to the performance of this function.

Lastly, we believe that the inclusion of a staff team with program expertise and with knowledge of computer and other management



systems techniques is a very important element in our Office of Inspector General. We have staffed this unit with 15 hand-picked senior specialists but expect to double its size in the coming year.

This concludes our testimony, Mr. Chairman. We would be pleased to answer your questions.

Senator NUNN. Thank you, Mr. Morris.

Senator Percy, you have not had a chance to give your opening statement. If you would like to give it now, go ahead.

#### OPENING STATEMENT OF SENATOR PERCY

Senator PERCY. Fine.

I would like to say, Mr. Chairman, we have two distinguished witnesses today. I have carefully looked at their background. Of course, we knew about both of you before. But I think that both Mr. Morris and Mr. Ruff are eminently qualified.

When we talk about the bureaucracy, I guess we are all part of it in a sense. But I think that for either one of you, having had the kind of backgrounds you have had, any major corporation, any major auditing firm management consulting firm in this country, would be very proud to have you in top management positions. So I think in this regard the Government is getting the very, very best that can be provided. Your experience and testimony today are, for that reason, extraordinarily valuable to us. It will help us immensely as we develop the legislation Senator Eagleton is working on.

Over the past several years, we have closely examined many of the programs within the Department of HEW. The full Governmental Affairs Committee has had recent occasion to review the Head Start program, for instance, in HEW to determine whether it should become a part of the Department of Education.

My own examination of that program right from the inception has given it very, very high marks. I couldn't be more laudatory in my comments about it. We resisted, all of us, the effort to put it into the Department of Education. It was performing extraordinarily well in HEW. So that when we criticize HEW today, we do so not from the standpoint that everything is wrong. HEW is a huge organization and has a large bureaucracy. We want to be highly selective in our criticisms.

But I must say that too many times, when we look closely at them, programs are riddled with fraud, waste, mismanagement or incompetence. If anyone ever tried to run a business like HEW runs some of its affairs, he would not only go bankrupt, but he would probably be lynched by the stockholders. The Government, on the other hand, would probably hire him as a consultant.

We have a very uneasy and uneven situation even in some outstanding programs. There is a standard of excellence in some programs that can be and should be achieved by the entire operation. We have closely examined specific HEW programs through the years, and we have found a tremendous area for needed improvement.

Three years ago we heard testimony exposing fraud and abuse in Federal student loan programs. In 1976 we uncovered serious mismanagement and cheating in the medicaid management information

systems, a project that was intended to show States how to run their medicaid programs more effectively.

At that time, with a budget of \$130 billion, HEW had fewer internal inspectors than the Department of Agriculture, which had a budget about one-tenth the size of HEW's.

My own experience is that internal revenue agents and internal auditors are probably among the most cost-effective parts of the Federal Government, just as internal auditing is the most cost-effective part of any good corporation.

This subcommittee has already seen that there has been great neglect of an area that should have been subjected to internal auditing, rather than requiring committees of the Congress or the Comptroller General's office to go in from the outside.

Because of the new emphasis on internal auditing in HEW, it is particularly rewarding to have Thomas Morris, the Inspector General, and Charles Ruff, the Deputy Inspector General, with us today. This committee discovered in 1975 that in the entire Department of HEW, only seven investigators were assigned to uncover fraud, waste, and abuse. At that time Senator Nunn, Senator Chiles and I decided that immediate and direct intervention by Congress was imperative.

We sponsored legislation creating the Office of Inspector General and urged that specific areas of fraud, waste, and abuse be identified within the agency. Thanks to that legislation the number of investigators in HEW has gone up from 7 in 1976 to nearly 80 this year. And the taxpayers' return on this investment will prove to be extraordinarily high.

In its first annual report, the new Office of Inspector General has estimated that over 7 billion hard-earned taxpayer dollars have been parceled out to crooks or channeled into wasteful, inefficient programs. That amounts to \$55,000 every minute of every working day.

The tragic story behind these amounts is that well-intentioned programs which are vital to the health and welfare of millions of Americans are being subverted, often by those who are hired to administer the programs.

I have visited nursing homes and health facilities throughout the Nation where corruption, waste, and mismanagement involving Federal moneys have been uncovered. I have done so in the company of other members on the Select Committee on Aging. But just this week the Better Government Association of Chicago and the ABC-owned television station in Chicago, WLS-TV, investigators came up with startling new revelations of nursing home abuse.

It is tragic to see how self-serving, inhumane opportunists exploit the infirmities of the elderly, emotionally disturbed patients, orphans, and physically handicapped persons—people in desperate need of human warmth and attention, who are incapable of caring for themselves.

We have come across examples where elderly and physically infirm patients are used as human guinea pigs for various forms of drug and shock therapy. Loneliness, apathy and despair are fostered by institutions designed, built, and supported by Federal funds, because unscrupulous or incompetent administrators will not provide patients

with the therapy they need most—kindness, understanding, and simple human dignity.

Yet our Federal programs allow a small group of unprincipled doctors and technicians to overdiagnose, overhospitalize, overoperate, and overmedicate, and in so doing reap enormous profits from the national treasury.

One particular instance is the point system used in some States, including the State of Illinois, where the more a patient is bed-ridden with bed sores, the more points they get and, therefore, the more compensation, presumably to take care of them more.

But what we have discovered is that about a third of the medication given by some nursing homes was sedation. They purposely gave sedation to patients to get them and keep them in bed, to cut their appetites, to cut food costs, to give patients bed sores so they could collect more money.

This was revealed by investigators that were put into nursing homes to work as employees, as investigators, by the Chicago media and other areas cooperating and working with the Select Committee on Aging.

The citizens of this Nation are compassionate and have shown they care about the poor and elderly, the blind and the disabled. But no American taxpayer should be asked to subsidize wasteful or inefficient government programs.

The national taxpayer revolt, heralded by California's proposition 13, is not a revolt against all Government spending. The attack is against Federal programs gone sour, against well-intentioned services that have been abused, against needless and inexcusable waste and mismanagement and corruption. And the revolt will not subside until we in Government respond.

The American taxpayers should not be asked to pay for excessive medical procedures and drug prescriptions. They should not have to tolerate student loan ripoffs, medicaid and medicare over-charges, mismanaged and too-cozy Government contract procedures, and incompetent or unethical program administrators. They deserve honest and fair use of their tax dollars.

The Inspector General, in his first year of office, has identified numerous instances of waste, fraud, and abuse within the sprawling HEW bureaucracy. I know that he will want to expand on those findings, as he has in his testimony, and to suggest where Congress might further aid in tightening up that agency.

I trust that in the coming year we can move beyond simply identifying areas of weakness and begin recovering taxpayer dollars while handing down indictments against those who subvert vital social programs of the Federal Government.

Once again, Mr. Chairman, I just couldn't imagine two more competent and able public officials than we have with us today. I want to assure them, and you, that our purpose is to work in cooperation and in partnership to strengthen their hand in every way possible, but to keep the initiative with HEW. I know that Secretary Califano feels very, very strongly about that, and I want to assure him of our desire to cooperate fully with the concern he personally has expressed

about clearing up the abuses which long preceded his coming into office.

Mr. MORRIS. Thank you, sir.

Mr. RUFF. Thank you.

Senator PERCY. Thank you, Mr. Chairman.

Senator NUNN. Thank you very much, Senator Percy. I have several questions.

Off the record.

[Discussion off the record.]

#### TESTIMONY OF THOMAS MORRIS AND CHARLES RUFF—Resumed

Senator NUNN. Mr. Morris, you estimate that as much as \$7.4 billion in HEW spending is lost because of fraud, abuse, waste, and mismanagement. Of course, that was a startling disclosure to a lot of people in the country. Even though the estimate has been revised downward to a possible loss of \$6.5 billion, that figure remains mind-boggling. What percentage of total HEW outlays does this estimate represent?

Mr. MORRIS. Of the outlays we examined, sir—which were \$136 billion—it is about 5 percent, between 4½ and 5 percent.

Senator NUNN. Of the total HEW budget?

Mr. MORRIS. Yes, sir.

Senator NUNN. Did you consider every outlay? Were you starting from 100 percent in determining this \$6.5 billion?

Mr. MORRIS. No, sir. I would like to explain just a minute how we did this and why we did it. This is not a scientifically determined survey. We assigned a team of crack auditors to read back congressional testimony, talk to key people and staff on the Hill, in the department, in GAO, and try to assemble the best picture they could and place estimates on fraud, abuse, and waste around specific programs.

That is what this inventory is. It was an amazing product in the sense that once aggregated, organized, classified, and added up, for the first time, it called into clear perspective where the major opportunities seem to be and where the priorities might best lie.

So that is the nature of the inventory. It is both its strength and its weakness. We know that it is incomplete. Some of the estimates are crude; some are quite good. But our first recommendation in the annual report is that we repeat this type of review at least once a year and attempt to find better data each time we do it.

Senator NUNN. Of the \$6.5 billion, how much is under the direct control of the HEW administration?

Mr. MORRIS. Between 40 and 50 percent, sir; about \$2.7 billion, as pointed out earlier in the statement and amplified in the inserts for the record. It is about \$2.7 billion, which is 40 to 50 percent of the \$5.5 to \$6.5 billion of potential losses.

Senator NUNN. Where is the rest of it administered? Is that by grantees and State and local governments and so forth?

Mr. MORRIS. I am sorry, sir. I probably answered the wrong question. The \$2.7 billion is that which we can directly control with our present legal authorities and resources in the sense of doing

something about the problem. The remainder of that dollar amount is what requires more resources or new legislation or new research.

Most of the money that we deal with is spent by other people. The biggest portion, of course, is social security payments to beneficiaries. That is like \$100 billion out of the \$136 billion. Medicaid and medicare payments are made to beneficiaries. The grant programs, title 20, and the research grants program of universities, are all made to grantees and beneficiaries. Very little of this money is spent inhouse is the point. Ninety percent of it almost is entitlements established by law.

Senator NUNN. Mr. Morris, how long were you in the Department of Defense and what were your positions there?

Mr. MORRIS. I was there approximately 8 years, sir. First, as Assistant Secretary for Installations and Logistics; second, as Assistant Secretary for Manpower.

Senator NUNN. About 8 years?

Mr. MORRIS. Yes, sir.

Senator NUNN. What period of time was that?

Mr. MORRIS. 1961 through 1968.

[At this point Senator Percy withdrew from the hearing room.]

[The letter of authority follows:]

U.S. SENATE,  
COMMITTEE ON GOVERNMENTAL AFFAIRS,  
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,  
Washington, D.C.

Pursuant to Rule 5 of the Rules of Procedure of the Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, permission is hereby granted for the Chairman, or any member of the Subcommittee as designated by the Chairman, to conduct hearings in open session, without a quorum of two members for the administration of oaths and taking testimony in connection with Fraud, Abuse and Waste in Federally Supported Health Programs on Thursday, July 20, 1978.

HENRY M. JACKSON,  
*Chairman.*  
CHARLES H. PERCY,  
*Ranking Minority Member.*

Senator NUNN. Do you have any personal observations as to how the management of HEW can surpass the management of the Department of Defense?

Mr. MORRIS. That is a very difficult thing to do, sir, with any realism because the Defense Department is unique with its large corps of career and highly trained and highly motivated military personnel, as well as its excellent civilian corps.

Most of its costs in peacetime are controllable. So to save money in Defense, you do it by closing bases or reducing waste in inventories, things that managers internally can do.

In the HEW setting you are dealing with people outside the Department—in States, grantee organizations, and elsewhere—who are spending those moneys independently—under your regulations, to be sure—with a great deal of individual independence. So you don't have the control over them.

They, in turn, depend on the eligibility determinations of beneficiaries who must report to them when their circumstances change. If they don't make timely reports, then their eligibility tends to be erroneous.

HEW is a far more complex and difficult agency to manage economically than DOD in this sense.

Senator NUNN. Turning to Project Match, as I understand it, you use the computer to see if Federal employees are also receiving welfare and student aid funds. I believe your testimony is that you have identified 30,675 potential cases of so-called double-dipping, and 20 percent of your figure, or 6,000, Federal employees may actually have defrauded the Government.

In terms of converting those figures into dollars, how much money may be involved here?

Mr. MORRIS. Sir, the average payment, as best we can estimate it for welfare recipients nationwide, would be on the order of \$2,000. The Federal share is on the average of about 55 percent. So you can multiply \$2,000 by 6,000, which would produce overall losses of around \$12 million. We are estimating the Federal recovery will be about half that, or \$6 million.

Senator NUNN. About \$6 million?

Mr. MORRIS. Yes, sir. And the States picking up the balance.

Senator NUNN. You identified about 9,000 potential cases of State employees receiving welfare checks. Do those 9,000 cases represent potential abuses?

Mr. MORRIS. Sir, the 9,000 number that we have reported are not people in State employment, but people drawing public assistance payments from State agencies in more than one State. What we have done is to take 26 State welfare tapes and roll them into one tape and match them. So wherever we have a duplicate name and social security number in more than one State, we can name the location. We have furnished the States concerned the results of this and they are now checking with each other to see where there is double-dipping. We think this may be a very useful thing to do, in a timely way, about once a year.

Senator NUNN. Do you have any idea how much money is involved in this in terms of abuse?

Mr. MORRIS. We would simply be guessing. Again the \$2,000 index number is one we would apply. That would be \$18 million. The 9,000 universe is drawn from only about 75 percent of the AFDC population. So the total loss initially would be on the order of \$20 million, let's say, as a possibility. But that is just a guess at this point.

Senator NUNN. Right. One of the things our subcommittee got very involved in, as you may know, was the guaranteed student loan program. Out of that investigation flowed a great number of criminal indictments, including some not related to the program but that overlapped into other areas. Also I think that our subcommittee investigations stimulated some changes in the law as well as some real emphasis at HEW on doing something about it.

At the time we got into this, in 1975, we estimated there was about \$1 billion in the loan defaults. Could you update us on what kind of records you have uncovered in the student loan program as far as defaults on loans and fraud abuse?

Mr. MORRIS. Sir, one of the first things Mr. Califano observed that needed to be done in the Department was to organize a separate bureau to address the whole problem of student financial aid. It is

very complex. It was splintered in the prior organization. So today we have a single structure. For the first time those people are able to begin to put the spotlight on the total problem.

There are several student loan programs. Guaranteed student loan [GSL] was the one that you held hearings on, and has been the best known. That is the federally insured program. Today the estimates are that there are about 370,000 defaulters in that program. About \$400 million are in default—principal and interest.

But, in addition, there are the State insurance programs where the Federal Government reinsures the loan. There are an estimated 280,000 defaulters totalling \$390 million in principal and interest in these programs.

Then finally there is the national direct student loan program operated by the educational institutions using Federal funds. Just recently more about that program has become known to the Federal level. We estimate 700,000 defaulters in those programs, owing about \$600 million.

The sum of all of these is about 1.3 million defaulters who owe around \$1.4 billion.

There are very aggressive programs now being energized by the Department to attack all three programs.

Senator NUNN. Out of the \$1.4 billion total, what is your own estimate—I know it will be a rough estimate—of what can be collected?

Mr. MORRIS. Sir, we have no expertise or experience base upon which to estimate at this time. The only thing we personally have done is to run the HEW payroll against the student loan default file. We found 317 defaulters. This has been in the press. And upon contacting those that we have been able to reach, over half have returned to payment status. They are obviously under our control. If they are going to keep their job, they are going to respond.

Senator NUNN. You have more leverage over them.

Mr. MORRIS. Yes, sir. Whether that is true of the general population is hard to tell. But we are documenting that very carefully.

Senator NUNN. Those people who have defaulted on loans, that are on your payroll and who have since repaid them; what was your general assessment of the motivation of those people in defaulting? Were they just treating it as a give-away program that they didn't have to pay back and nobody was going to do anything about it? Were they generally in financial difficulty and simply couldn't pay it back? How would you characterize this kind of abuse?

Mr. MORRIS. Again, we lack direct personal expertise. But what happens most frequently is the program itself is so poorly administered that the Federal people had lost the ability to run an ordinary business-like collection system. They had made no contacts with some of these in default for years—3 or 4 years.

Those persons that were not being contacted had no incentive to pay back. Now that we have energized the system so that they are put on notice and are getting regular collection contacts, they are responding.

Those are the facts as we see them right now.

Senator NUNN. How many Federal employees have you found that defaulted on student loans thus far?

Mr. MORRIS. In the GSL program, 6,783 including HEW.

Senator NUNN. 6,783?

Mr. MORRIS. Yes, sir.

Senator NUNN. How about State employees? Have you done any matching there?

Mr. MORRIS. No, sir.

Senator NUNN. Is that something you are going to do?

Mr. MORRIS. We want to work with the State guarantee agencies to see if we can do this.

Senator NUNN. One other point on Project Match I am interested in is your view about matching death tapes with payment files. Are you suggesting that there are welfare payments being received by persons who are filing claims in the names of dead people?

Mr. MORRIS. We would like, as a matter of research, to make tests to determine whether that is a possibility. There have been some indications from work our audit people have done in the medicare program that there were such situations where claims were being filed for Medicare reimbursement after the death of the individual. That is what led us to want to collect some State tapes and make runs.

In addition to medicare, we would like to test AFDC and perhaps SSI and SSA regular payments.

Senator NUNN. You must suspect there is some real abuse here.

Mr. MORRIS. Based on the medicare review, we did find some abuse. And as I say, we just want to research this and see if it is a productive thing to do. It has never been done before is the point.

Senator NUNN. Is this a practice they call "tomb-stoning" on the street? Have you ever heard that description?

Mr. MORRIS. No, sir. It sounds descriptive. [Laughter.]

Senator NUNN. Where do you get a computer tape with the names of people who have died? Who keeps a record of that?

Mr. MORRIS. This, sir, is available to us only on a State-by-State basis, the vital statistics agency of that State wherever it may be. We have to make arrangements with each jurisdiction to get access to the tape.

Senator NUNN. Are they cooperating so far?

Mr. MORRIS. Thus far we have only worked with three and they are cooperating.

Senator NUNN. Doesn't HEW have on tapes the names of people who have died?

Mr. MORRIS. Within HEW, the National Center for Health Statistics does develop mortality data and makes regular publications. But their own statute prevents them from making those data available to anyone else. So we, just like everyone else, are not entitled to use their own records. It would take a change in the law to permit that.

Senator NUNN. What is the philosophy behind that prohibition?

Mr. MORRIS. I assume, sir, simply a matter of privacy. But I frankly don't know the legislative history. I might ask Mr. Ruff if he knows.

Senator NUNN. Mr. Ruff, do you know the legislative prohibition background?



Mr. RUFF. I think only in those general terms, Senator, that the fear was that private enterprises of one kind or another would get access to these tapes and use them for commercial purposes.

I am not sure the issue of whether or not there should be an internal disclosure to something like the Inspector General's office was ever even addressed at the time the statute was enacted.

Senator NUNN. Would you have anybody on your staff that could give us a little background on that, too?

Mr. RUFF. We would certainly be glad to do that, sir.

[The information supplied follows:]

PHS has been working with representatives of the American Association for Vital Records and Public Health Statistics, the national organization of State vital registration and statistics executives, in an effort to establish a National Death Index (NDI). The Association endorsed plans to establish the NDI at its annual meeting in June. This endorsement was granted, however, with the understanding that the use of the NDI would be limited to statistical studies concerned with medical and health research. Such a limitation would preclude the use of the NDI for the investigation of fraud and other administrative or legal purposes.

Death records are filed under State laws, and they are the property of the States. Information can be used from these records in establishing the NDI or in producing national mortality statistics only with the written consent of each of the States and only for the purposes agreed upon on a contractual basis. A meeting will be held in the near future, including representatives of the OIG, NCHS, and OGC, to discuss further how the State data might be made available to the OIG.

Senator NUNN. If the office feels that the law should be changed, we would like to know that. Is there a specific intention to carry the right of privacy to the grave?

Mr. RUFF. I am not certain, Senator. My general experience is that in the courts and in other statutory attempts to address the privacy problem those who have died are generally considered no longer to be entitled to quite the same protections that the living are. But I will certainly have somebody explore that and report to the committee.

Senator NUNN. It is probably a corresponding right of the dead not to have false claims filed in their name, wouldn't you think?

Mr. RUFF. I suspect so.

Senator NUNN. I think we have to balance the right of privacy against that right. I would like to know about that because it seems to me for HEW to go around State to State to get this information, when your own department has a computer file on it, if the right of privacy is being violated, it is being violated just as much by going and getting this information from State governments as it would be if you went across the hall and got it from your own computer tape. I don't see how we philosophically could separate those two actions. If one is wrong, the other is wrong. If either is acceptable, it seems to me the quickest, cheapest, easiest way would be to walk across the street or wherever you have to go and get the computer tape from your own office; don't you think?

Mr. MORRIS. We want to be very fair to our sister agency. Their law does not permit them to give us the tapes.

Senator NUNN. I understand the law is there. We are not in any way criticizing them. That is something that we in Congress could possibly address.

Mr. MORRIS. Right, sir.

Senator NUNN. At the close of your testimony, Mr. Morris, you proposed that Congress consider establishing a law requiring the regular collection and match of Government employees names and social program rolls. Do we need a change in the law to accomplish this purpose?

Mr. MORRIS. Sir, it does require a change in the law. But we think that it might add a discipline and a regularity to doing this, just as Congress elected to do last fall in the matching of State welfare rolls against wage earner data available either in the States or to Social Security Administration.

That means Congress has said to the welfare agencies, "Every year from now on you must determine from the wage earning records if people are on AFDC in your State."

These are private employer records. There is no similar provision covering Federal civil service employees who are not under the social security system and therefore don't have the same reporting requirement. We think it would be a useful thing to put the discipline into being for regular matches of the entire Federal employee universe against welfare rolls and against other rolls like food stamps, unemployment insurance, and so on.

Senator NUNN. You discussed in your testimony the possibility of kickbacks by medical fellows to their professors of medicare and medicaid fees they have received. In December 1977 I sent a letter to you directing your attention to allegations we had in this subcommittee that medical residents at a west coast medical school were kicking back fees to their professors. One source indicated that one group of professors may have received as much as \$200,000 in kickbacks.

It is our understanding that you have pursued the leads we have provided. I know this matter is under active investigation. I would presume you would not want to use any names of the universities involved or individuals involved. But could you go into a little bit more detail than you did in your statement as to the nature of this general allegation?

Mr. MORRIS. I would like to ask Mr. Ruff to address this.

Mr. RUFF. Senator, as you have indicated, we are indeed pursuing the material that you had submitted to us. It is actively under consideration in our Region Nine investigative office and in the U.S. attorney's office in San Francisco.

The general allegation there that post-resident fellows were billing the medicare and medicaid programs and receiving fee-for-service payments, which they retained part of as a salary and paid the rest back to either the institution or to certain private physicians, is one that is of special concern to us and particularly over the last few months has become of broader concern as we uncovered similar problems in other parts of the country.

The whole area of funding of teaching hospitals' physicians on a fee-for-service basis through the medicare and medicaid program has been, since 1968 or 1969, a very difficult one for the programs to come to grips with. The Congress, indeed, has made a couple of efforts to deal with the problem. As yet I think it is fair to say that, although the rules are there and clear at either end of the spectrum, there are

still gray areas governing the circumstances under which teaching physicians and physicians attached to teaching hospitals can file claims under the medicare and medicaid programs.

In addition to the situation which you referred to, which we are looking into, we have two other allegations which are at the present time under scrutiny both by our Audit Agency and by our Office of Investigation which range all the way from what seems to be the fairly clear situation where service is not, in fact, performed in any fashion by someone who is on the teaching staff of a hospital and yet a bill is submitted, although all of the work was done by the resident or intern, to the situation in which some supervision, some presence of the teaching physician is there, but clearly the bulk of the work, the substantial responsibility, is taken by the resident or intern.

To deal with this problem we really have to begin with the very difficult question of how you develop regulations and policies for the payment of these claims. It is my understanding that the Health Care Financing Administration is just now on the verge of issuing for comment a comprehensive regulatory approach to this problem. We had a meeting with them recently to talk about that and to see how it would impact on our criminal concerns.

In addition, it is important for us to explore whether or not there is actual criminal activity going on here; that is, whether in fact a physician who has some teaching or other staff responsibilities in a hospital knowingly does file a claim for something which he never in fact performed which, just as would be true with any other physician, would be the filing of a false statement.

We don't have, I think, enough information at this point to predict whether the matters that we have under inquiry will result in any criminal prosecution. We do have enough information to predict it is going to be an ongoing problem. And I think substantial education has to be done as well as specific inquiry into actual false claims for payment.

We are working very closely with the medicare bureau on the regulatory aspects of this problem and very closely with selected U.S. attorneys' offices on the criminal aspects of it and will be glad to report to the committee as our work along this line progresses.

Senator NUNN. Thank you.

One other aspect, as I understand the Internal Revenue Code, the payments received by interns or residents would be includable tax-wise, but if they gave kickbacks for services not performed to professors, and so forth, those kickbacks would not be deductible.

Have you looked into the tax aspects of it, or is that something you may refer to IRS?

Mr. RUFF. I make absolutely no pretense to have any expertise in the Internal Revenue Code, Senator. It would be my understanding that funds received would be presumptively taxable to the resident or the intern and that it would not be a business deduction for him simply to pass on a certain percentage of that to some third party.

Presumably, the Internal Revenue Service might be interested in how those functions were handled.

In a number of areas we are talking to the Internal Revenue Service about making information of this kind available to them so they can explore the tax consequence of this kind of activity.

I expect we will do it in this instance as well.

Senator NUNN. How long do you think it will take you to complete the phase of investigation to which you referred?

Mr. RUFF. It is very difficult to predict, but I think we would have at least some substantial understanding of what the prospects were by the fall.

Senator NUNN. Thank you.

Mr. Morris, we discussed previously the receipt of something of value of an employee of a grantee, which would not be a violation of the Federal law because they weren't direct employees of the Federal Government and the possibility of plugging up this loophole in the law. Do you have any specific examples in mind, again, without calling names, but giving us an example that would give us an idea of what you are speaking of?

Mr. Morris. I would like Mr. Ruff to address that issue.

Mr. RUFF. Senator, we do have one particular example that I could describe to the committee, but on the basis of this example and one or two other situations we are familiar with, we do see it as an ongoing problem which needs to be addressed.

In the particular situation I have in mind, in a Midwestern State, a number of employees of a carrier were indicted under Federal bribery charges, that is section 201 of title 18, on facts which indicated that they had received payments from health care providers to influence the manner in which payments were made.

The defense initially, at the pretrial motion stage, raised the applicability of that Federal bribery statute to the conduct alleged to have occurred. The judge upheld the validity of the indictment and a trial proceeded, and the defendants were convicted. But on post-conviction motions, the judge dismissed those counts, expressing his dismay that he was forced to do so but finding that those carrier employees, even though they were clearly acting on behalf of the Federal Government, and, indeed, were crucial to the administration of a federally funded program, were not public officials within the meaning of section 201, and therefore could not be the subject of a bribe under that statute.

I think that, with a carefully drafted and limited statute, again, so as not to overly extend Federal jurisdiction in this area, those who operate as the direct arm of the Department of HEW the administration's programs ought to be made subjects of some Federal protection against subversion of the integrity of those programs.

Senator NUNN. Who would be the people who were doing the bribing in this case, again, not by name, but what type of people?

Mr. RUFF. The specific case I described to you involved laboratories, who were paying employees of the carrier to approve the payment of claims that they had made that seemed clearly not to be qualified for payment under the program.

Senator NUNN. What we are saying here is, that someone who is bribed, and is doing the work of the Federal Government under

Federal law, and using Federal taxpayers' money, under the present law cannot be successfully prosecuted?

Mr. RUFF. That is correct. There may be, in some States, some form of commercial bribery statute which would be applicable, but that would depend on the changes that occur as you move from one jurisdiction to another. It seems to us that this is clearly a case in which the Federal Government has a strong interest in the integrity of the program and in which it would be appropriate to legislate.

Senator NUNN. On page 16 of your testimony, Mr. Morris, you say it is not a Federal offense to steal grant funds. Would you tell us what you mean by that, perhaps give us an example?

Mr. MORRIS. Mr. Ruff has been analyzing this problem.

Mr. RUFF. This is an ongoing concern to us and one that is perhaps not so clear as is the situation described previously. But we have at the very moment pending down in Texas and in the fifth circuit, three cases involving the theft of basic educational opportunity grant funds and other Federal funds from educational institutions. Those people were tried under section 641 of title 18, Theft of Government Funds. They were convicted and they are now on appeal in the fifth circuit raising as a defense the absence of Federal jurisdiction. And in raising that defense, they rely on the case of the *United States v. Collins*, which was decided in the ninth circuit in 1972, which held under comparable circumstances that, in fact, there was no definable Federal interest in grant funds that had been distributed to, in that case, a city agency, for use in aid of a federally sponsored program, so as to provide jurisdiction under section 641.

The situation in *Collins* was, indeed, perhaps as clear a case of Federal interest as one would normally imagine. The Labor Department, which provided the funds, required that they be held in a separate account and be separately accounted for.

Drafts were drawn on that account for specific expenditures and yet the ninth circuit held that once they came to rest in that account in the city of San Francisco, they no longer had sufficient Federal character to justify prosecution under 18 U.S.C. 641. Where the funds are perhaps less clearly identified in the hands of the recipient, we anticipate some difficulty in pursuing what seem to be legitimate Federal prosecutions in this area. It was for that reason that we suggested that some congressional attention be devoted to expanding the reach of the Federal theft-embezzlement-conversion statute to cover that kind of case.

Senator NUNN. What you are basically saying is, there is a great danger in grants as well as other types of Federal programs, that once the funds actually leave the Federal Government's direct control, loopholes in the law prevent successful prosecution of people who may steal or abuse those funds, or who may accept a bribe in carrying out their duties?

Mr. RUFF. There is certainly a high risk of that. And I think this is an area where the law can reach that problem.

Senator NUNN. Project Integrity is a computerized review of physician and pharmacy claims in the medicaid program. According to your testimony, about 1,600 cases are in either preliminary or

active stages, and the cost of the program is about \$8.2 million. You state that you believe that the project will be cost-effective. In addition to the convictions and indictments, could you give us specific examples of what you turned up through project integrity in significant field investigations?

Mr. MORRIS. Yes, sir. This project started in the late spring of 1977, based on work that our auditors had been doing in two selected States. They had developed computer screens for both doctors and pharmacists under which they were able to sort out quickly, by running all claims paid, those providers that appeared to be most aberrant. In a matter of 3 weeks, we ran 250 million claims in 49 States through the computers.

We examined payments made to 278,000 doctors and pharmacists—I just mention this to show the comprehensiveness of the review. Out of those printouts we then selected the top 2,500 cases—2,458; and working with the States where they have the capability and interest, we have been trying to analyze each case, to determine whether in fact funds should be recovered or whether criminal fraud is involved, or in fact just a plain error. About a third of the cases so far have turned out to be errors.

The others have proved to be very interesting cases of fraud or abuse. I might just read an example or two that came in last week from one of our field directors, who had finished a review of cases in one State. He said:

Among the services claimed and shown in the medical records of this case, there were about 10 sutures for repair of a laceration of the right knee, and two followup visits to have the wound redressed; facial boils drained on the right and left side of the face, and three followup office visits to have them dressed.

In our personal interview, the recipient told us she had not received any of these services.

In another case, according to the patient's medical records and claims submitted, this recipient had been provided four office visits, three blood tests, three urinalyses, and two cultures. This recipient told us he had never been treated by this particular doctor, though on one occasion he had driven his mother to the doctor's office and remained outside in the car.

In a third case, the medical records and claims submitted showed the recipient had been visited six times in her home for treatment of a heart attack. The recipient told us she had not been visited by the doctor. She says she once had a heart attack, but has had no problem for 4 years.

This illustrates the kind of egregious cases that we are sifting out and putting into the full field investigation category.

Senator NUNN. Mr. Morris, Mr. Ruff, I am sure you would agree with the general statement that most physicians are honest and honorable people, but there are very serious charges of abuse. I get complaints in the mail every day on this.

We refer some of them to you.

If we begin to successfully ferret out some of this fraud and put the spotlight on it, and if some people who are abusing the system and giving the whole profession a bad reputation, if they are successfully prosecuted, do you believe we are going to have a substantial deterrent effect on this kind of behavior or is it just a mind-boggling maze that by the very nature of the program we can only scratch the surface and it is just inherently fraudulent? In other words, are you optimistic

that we can begin to come to grips with this and encourage honesty in dealing with these programs, or is it hopeless?

Mr. MORRIS. Frankly, sir, I think all we can have is personal opinions. That is the reason we undertook this. We think if this ability is achieved, it is bound to have a beneficial effect. Mr. Ruff is an expert in these areas.

Mr. RUFF. I absolutely deny any expertise in the human nature of those who might attempt to defraud the Federal programs, Senator. I guess my own reaction is that we will, by criminal prosecution, be able to deter the vast majority of those who perhaps are teetering on the brink of deciding whether they should abide by the law or not abide by the law.

We will never be able to deter that group of people—and I think it is a small one basically—which would defraud the program, were we to have a death sentence for stealing money from HEW.

We think, though—and it is important to stress that the criminal sanctions simply are not enough—that, in addition to restructuring the programs so that it makes it a lot tougher to defraud HEW or to abuse the program, we need a wider range of sanctions. That was one of the reasons why we suggested in our annual report the value of something like a civil penalty bill so we can reach out rapidly and impose a meaningful monetary sanction on those who do defraud us without having to go through the full-blown criminal process. The U.S. attorneys and the State agencies can, in fact, handle very few of these cases.

Senator NUNN. What about your medical associations and your pharmaceutical associations, are these groups willing to cooperate? For instance, I can envision cases that would involve ethics that would not involve violations of the law.

Do you have any plans to defer potential ethical violations to these associations in the respective States that would not be prosecutable?

Mr. MORRIS. We have not gone to the associations on that basis. We have kept them informed and sought their counsel and cooperation in these matters.

I would personally hope that groups like PSRO's, perhaps, and other peer groups, might take an interest with us in the kind of matters you are discussing.

Do you have further thoughts?

Mr. RUFF. No, I think it is important that we enlist the aid of the professional organizations. I think, by and large, they are interested in improving both the ethical and the purely legal standards of their members. I think, though, that, as Mr. Morris suggests, it is not wholly a role for us. I think the entire structure really needs to address that problem, the PSRO's, the program agencies as well as the Inspector General's office.

Senator NUNN. I encourage you to think about talking to the professional associations about referring to them cases which you do not have legal authority to pursue, that are not clear ethical violations.

It seems to me the States have a duty to clean up their own house. In every conversation I have had with them, they have indicated they will do that.

It looks like to me there are going to be an awful lot of cases that fall into the category of being ethically questionable rather than absolute violations of law.

Would you look into that?

Mr. RUFF. Certainly will, Senator.

Senator NUNN. Mr. Morris, you say in your testimony there are 50,000 auditable entities within the scope of the audit agencies' responsibility. In the normal course of a year, how many of these different agencies are actually being audited?

Mr. MORRIS. Sir, we are generally processing about 7,000 audits a year out of the 50,000 universe.

Senator NUNN. About how many?

Mr. MORRIS. About 7,000.

Senator NUNN. On page 20 of your prepared statement you said that during the past 3 fiscal years your audit reports have questioned between 156 million and 194 million. This amounts to about 400 million. How much has actually been collected during that time frame?

Mr. MORRIS. Unfortunately, we do not have an answer to that question today. We became aware of the fact that we needed to address this several months ago and are now looking at it intensively and will have an answer this fall and be glad to report to you.

We know we have had a very spotty performance. But I don't have the numbers yet.

Senator NUNN. Who is responsible for collection once these audits identify amounts that are outstanding?

Mr. MORRIS. It has been left to the individual program agencies to follow through and take the final action.

Our Assistant Secretary for Management and Budget, however, has now set up an accounts receivable monitoring system in his own office so that he will keep constant track of what happens. If he sees a failure or if we see one, we will go to the Secretary and ask for his attention to that matter.

I might say the Secretary has been very responsive to requesting the program agencies to promptly resolve audit reports and they are doing much better today than they were a year ago.

This collection phase has been something that hasn't been given the same degree of attention.

Senator NUNN. We have had auditors in HEW for many years, I suppose ever since the Department was created.

We have had auditors before your office was created. Are you basically saying there never has been an organized methodical program in HEW to collect outstanding funds that are owed to the Government?

Mr. MORRIS. We are saying that this has never been a matter of priority attention. That is quite true. I suspect it is generally among audit agencies. But we are not going to let that continue.

Senator NUNN. Could you furnish us with a record of the last 5 years, and the record of the last 10 years of the amount of moneys that audits have identified as being owing to the Government within HEW? In addition, could you provide a comparable figure which



shows how much of that identifiable money has been, in fact, collected?

Mr. MORRIS. We can do the former, probably, sir, but the latter, I doubt very seriously is possible. We will be able to do it for the last year, because the system was begun a year ago.

[The information supplied follows:]

The following schedule displays dollars questioned by audit and concurrences by program officials during the period FY 1969 through July 31, 1978. With respect to dollars questioned by audit, experience has shown, in most cases, these amounts were questioned because there was a lack of documentation to support that they were disbursed for the purpose authorized; or were in-correctly determined based on rates or terms other than those authorized by the covering instrument. Concurrences by program officials reflects the amount of audit questioned costs with which program officials were in agreement. This amount does not necessarily reflect actual collections, in that subsequent to the concurrence, the grantees/contractors involved may have submitted costs involved. Effective March 1977, the Department required each Principal Operating Component to set up an accounts receivable to record and account for sustained audit disallowances and record their subsequent disposition.

HEW AUDIT AGENCY—SCHEDULE OF AMOUNTS RECOMMENDED FOR FINANCIAL ADJUSTMENT AND CONCURRENCES  
BY PROGRAM OFFICIALS

[Submitted at request of Permanent Subcommittee on Investigations of the Committee on Governmental Affairs.]

[Dollar amounts in millions]

	Amounts recommended for financial adjustment	Concurrences by program officials
1969.....	\$98.2	\$1.9
1970.....	72.3	22.7
1971.....	100.4	23.2
1972.....	116.1	27.8
1973.....	80.1	71.7
1974.....	140.2	72.4
1975.....	161.5	100.2
1976.....	134.1	111.7
1977.....	159.6	73.5
1978 (10 mo).....	116.2	43.2

NOTE: At July 31, 1978, \$213,900,000 of amounts recommended for financial adjustment were awaiting decision by program officials.

Senator NUNN. You are saying nobody in HEW, until a year ago, could tell how much money was collected on outstanding accounts?

Mr. MORRIS. I am very much afraid you are going to find that to be the case without investing an effort that would not be cost-effective to dig up the records.

Senator NUNN. How could this be? I cannot visualize a company or a city government or a State government or any department of Government not knowing how much it had collected on the basis of its own audits. To me it is incredible.

Mr. MORRIS. I fully agree that there has not been enough sense of urgency in following through on these matters, once they are decided. They have tended to drift out of priority concern, and nobody has paid attention to them, including our office, in the past. We are now very aware of it and will not let it continue.

Senator NUNN. Someone once said we need an "American desk" in the State Department. What you are saying is that, we don't have

any desk at HEW until you got involved, that had anything to do with collection of money—no organization for collection, only an organization for disbursement of funds.

Mr. MORRIS. We have done a good job of finding the problem, identifying what is due us, but we haven't done a good job of following through.

Senator NUNN. It doesn't do much good to have an audit if there is no collection procedure?

Mr. MORRIS. Some agencies which disburse money can always offset payments and recover quite easily. Others can't do it as readily. That is the reason we have a spotty result.

Senator NUNN. In 1975, we had, as I have already alluded to, a federally insured student loan program investigation. At that time we found that the master file of the student loan program was replete with errors that it really didn't have any value. What is the present status of the student loan master file?

Mr. MORRIS. If I may, I would like to furnish for the record a precise answer. But I can tell you generally.

Since last fall, when the Bureau of Student Financial Assistance was organized, and a professional manager with computer capability was brought in, this matter has been one of his highest priorities. They have made some progress. How much further they need to go, I would like to reserve that for the record, if I may.

[Additional information subsequently supplied by Mr. Morris follows:]

The student loan control master file is the major information file on loans issued under the Guaranteed Student Loan Program. The information for this file is obtained from several sources including:

The original loan application; The lenders disbursement records; The schools enrollment status; The lenders sale of loans; The lenders status on loan repayment; and The lenders claim on student default.

Key current processing steps that involve the loan file are:

#### STUDENT LOAN APPLICATIONS

Subsequent to the student applying for a loan at a lender, the lender submits the application to the Office of Education for loan guarantee and interest subsidy. Application forms submitted are checked against the information in the loan file. If a student is in default on previous loans or applying for a loan beyond the total commitment limitation, the commitment for guarantee on loan applications is denied. If the Office of Education guarantees the loan, proper entry is made in the loan file and the approved application is returned to the lender.

#### LENDER DISBURSEMENT

If the loan application is returned to the lender as approved, the lender disburses the money to the student and notifies the Office of Education of this action. Disbursement information is added to the student entry in the loan file.

#### STUDENT PAYMENT TO SCHOOL

The student enrolls in the education institution and pays tuition. Subsequently, the Office of Education requests the school to supply student status information. The student status information is added to the loan file.

#### LENDER PAYMENT FOR INSURANCE PREMIUM

The Office of Education bills the lender for insurance premium, a one-time charge. In turn, the lender makes payment to the Office of Education.

## LENDER BILLING FOR INTEREST SUBSIDY AND SPECIAL ALLOWANCE

Periodically, lenders submit bills to the Office of Education for interest subsidies and special allowance. Upon receipt of bills, the Office of Education pays the lenders.

## THE LENDERS SALE OF LOANS

The lender is able to sell student loans to other eligible lenders. When this action occurs, the lender informs the Office of Education that he has sold the loans. Subsequently, the Office of Education makes entry of this change to the loan file.

## LENDER CLAIM SUBMISSION

From time to time lenders submit claims for loans because of student default or student death, disability or bankruptcy. Upon receipt of claim, the Office of Education checks the loan file for previous commitment information. If the loan file has no entry (no commitment made), the claim is denied. In summary, continuity is maintained in managing the Guaranteed Student Loan Program throughout a long-term time period with the assistance of the loan file information.

## SIGNIFICANCE OF ERRORS

Errors in this file can be of primary nature or of secondary nature. A primary error would be if a student, who has received a commitment, does not appear in our files at all. Although we have no way of positively checking this, circumstantial checks, such as the update of the file with claims default, indicate that this percentage of error is small. Secondary errors would be errors in individual data fields within a student's record. Some of these errors are of a processing nature, such as duplicate information on loan disbursements. While we know of the existence of such errors, they appear to be minor and do not affect the overall operation of the program. Other secondary data errors relate to the massive job of tracking several million students, who frequently change schools, drop-out, and are otherwise in a very mobile period of their lives. This represents our largest error factor, (errors related to timing on data updates) and can affect the program. If data is not timely, we are unable to advise the lender of those students whom they should pursue for collection.

## CURRENT IMPROVEMENTS

Two key improvements are currently being made to enhance the condition of the loan file. First, pre-claims assistance information is being improved. Lenders who are unable to locate students will request assistance from the Office of Education. Through the use of the loan file and other information (e.g., IRS files) the Office of Education will attempt to make contact with the student. In turn, the student will be urged to make contact with the lender and thus reduce lender claims. Second, Office of Education and Bureau of Student Financial Assistance personnel are examining improved reporting methods for the student status. A task force is analyzing present reports (e.g., loan transaction statements, student confirmation report) in an effort to produce more accurate, concise, timely student status information and to accurately record these data in the loan file. In summary, while steps have been taken this past year to improve the accuracy of the loan file, added measures are being planned to be implemented to eliminate secondary error conditions.

Senator NUNN. Is HEW using private collection agencies now to try to collect some of the student loans?

Mr. MORRIS. We have requests for proposals issued in the last few days for two demonstration projects, one on the east and one on the west coast to test the use of commercial collection support. We are not doing it extensively, in other words, at this time. We are augmenting our own staff, though, quite substantially.

Senator NUNN. In attachment 2 of your testimony, you outline the caseload in the Office of Investigations, and I believe that your statement shows that there are 178 pending cases in the Office of

Education, and only 143 in the Health Care Financing Administration.

In your testimony you say that medical payments programs, involving billions of dollars a year, are an area of great abuse. About four-sevenths of your identifiable waste was in this area. My question is: Why are there more cases pending in the Office of Education with approximately \$10 billion in expenditures, than there are in the whole Health Care Financing Administration?

Mr. MORRIS. Let me mention that project integrity is all health care. Those 501 cases really should be added to the 143, meaning that two-thirds of our total backlog is health care.

On the other hand, you are quite right, we have a large accumulation of cases primarily in the student financial aid field. Out of 178 Office of Education cases, 127 deal with problems in student financial aid. About half of them involve individuals who may have defrauded us, not completing their education, yet keeping all of the funds, with the remainder involving institutions that may have been fraudulent.

We need to triple the number of staff years applied to that work, and we plan to do so just as quickly as we can augment our work force.

Senator NUNN. Are you finding any difficulty either in HEW or at the Office of Management and Budget in getting the administration to support your request for personnel?

Mr. MORRIS. No, sir, we are being given in fiscal year 1979 what we require. It just takes a whole year budget cycle to get the budget approved.

Senator NUNN. Who clears your budget request? Does your request go first to Secretary Califano and then OMB?

Mr. MORRIS. Yes, sir, and then the Congress.

Senator NUNN. Your testimony is Secretary Califano has given you complete cooperation?

Mr. MORRIS. Yes, sir.

Senator NUNN. What was the impact of your report that came out showing at that time I think \$7.4 billion in waste in HEW? What was the reaction in HEW to this?

Mr. MORRIS. The most satisfying reaction from our point of view was the fact that Secretary Califano immediately issued a directive to all the program agencies to study the report and to give him plans for cost reductions. He set a date—I think it was a month after his directive. Those plans were returned to him, and were approved by him on June 6, 1978. That is one of the two inserts for the record. Thus within 2 months after our report, we have, a completely comprehensive cost reduction program—directed by the Secretary of the Department—including the areas addressed in the report. That is what we hoped would happen, Mr. Chairman. We are delighted it worked that way.

Senator NUNN. Do you have the degree of independence you need under the law?

Mr. MORRIS. Yes, sir.

Senator NUNN. Who can fire you, Mr. Morris?

Mr. MORRIS. I serve at the pleasure of the Secretary. I am a Presidential appointee.

Senator NUNN. What are the requirements for your dismissal? Are you just like any other person in HEW?

Mr. MORRIS. Like any other Presidential appointee, the same is true of Mr. Ruff.

Senator NUNN. Is there any requirement that there has to be a reason given if you are terminated?

Mr. MORRIS. Our act does contain that requirement; the proposed new Inspector General bill does not. We frankly don't think this is a very consequential requirement to have in the statute.

Senator NUNN. You think if someone decides to fire you, they could always find a reason?

Mr. MORRIS. Sure. And I frankly don't feel our kind of office can succeed if it is totally in an adversary role. We cannot be effective if we are fighting all the time. We must have top management support, as well as congressional support.

Senator NUNN. Is Mr. Ruff in the same category you are?

Mr. MORRIS. Yes, sir.

Senator NUNN. You are both confirmed by the Senate?

Mr. MORRIS. Yes, sir.

Senator NUNN. You are saying at this stage you don't see any need for any more insulation?

Mr. MORRIS. No, sir.

Senator NUNN. Do you concur in that, Mr. Ruff?

Mr. RUFF. Absolutely.

Senator NUNN. Our subcommittee has received information that the personnel of the Division of Investigations of the Office of Inspector General have filed charges with the Civil Service Commission alleging that the Office of the Inspector General is being managed in a way which is a detriment to the purposes for which the Inspector General's Office was created. I am not proposing we go into all of those issues, but just generally, are the criminal investigators now assigned to the Division of Investigations career civil service employees?

Mr. MORRIS. Yes, sir, they are all in a special investigative series, known as 1811, which entitles them to the early retirement provision.

I was not aware that any formal filing had been made with the Civil Service Commission. We have had continuing dialogue with many of our field special agents in charge over the past 4 months regarding our conclusion at headquarters that we need a Division of Special Assignments that would contain a small number of attorneys with experience in developing and prosecuting white collar crime. We have no such people on our investigative staff except its director.

Thus, today we have to depend upon the U.S. attorney for that kind of skill. Having a small increment of such people in our own house will enhance our capability to do better work and to take better cases to the Department of Justice. That is the issue we discussed with the secretary and our special agents. It is now understood by our people, and I hope they will find it very beneficial to them, as we are sure it will.

Mr. Ruff has lived through this whole experience and would be glad to comment further, if you would like, on it.

Senator NUNN. Mr. Ruff, why don't you complete this question and I will consult with staff when I get back. I know Senator Percy is going to have a good many questions and we both are going to have to adjourn at 12 o'clock.

I have about 4 minutes before I vote. If you finish this for the record, and I will return as soon as I can. Senator Percy will return and start his questioning.

Mr. RUFF. I think the only thing I would add for the record is we consider that the process of investigating white collar crime really requires a mix and variety of skills. So far in the past 15 months we managed to achieve a blend of the auditing-financial analysis skills, as well as those of the trained criminal investigator. My experience over the years has indicated to me—

[At this point Senator Nunn withdrew from the hearing room.]

Mr. RUFF [continuing]. That the assistant U.S. attorneys and assistant district attorneys who have been experienced in white collar crime prosecutions have themselves developed a special expertise in the way these cases should be managed and investigated. It is that expertise we hope to bring into our office by taking on some five or six highly experienced white collar crime prosecutors who will serve as task force leaders, and who will run the special and particularly complex investigations for us.

My hope is, without being too parochial about the skills of prosecutors, that the addition of this group will greatly enhance our ability to deal with extremely complex cases.

[Brief recess.]

[Members present at time of recess: None.]

[Members present at time of reconvening: Senator Percy.]

Senator PERCY [presiding]. Mr. Ruff, Mr. Morris, we will just move right ahead and hopefully be finished up in half an hour.

As I did mention, 3 years ago we held hearings into the Federal student loan program after a very intensive investigation of West Coast Schools, a technical institute in California. The results of that investigation were, to say the least, very astonishing to those of us who engaged in it.

West Coast Schools was found literally to be an offspring of the inadequacies in the student loan program. In a sense they were a microcosm of the worst that could go wrong with the program.

The institute relied almost exclusively on Office of Education loans to cover its expenses. It issued loans for almost seven times over its HEW-approved ceiling, improperly offered commissions to officers of banks and credit unions who bought these loans from the institute, and willfully concealed student enrollment and attendance information from the Office of Education auditors and from lending institutions.

Our investigation even uncovered the fact that Fred Peters, the director of West Coast Schools, was operating under an assumed name after he faked his own murder in Texas to avoid paying alimony. In your annual report, you indicate that a special task force in Dallas is investigating these types of abuses throughout the Southwestern United States. Has that task force uncovered abuses similar to the West Coast Schools example?

Mr. MORRIS. I would like Mr. Ruff to address this, if I may.

Mr. RUFF. I think, Senator, that the task force in Dallas, although I am a little reluctant to go into detail because these are matters pending before grand juries in the northern district and under criminal investigation, it is fair to say it has uncovered a wide range of violations, all the way from schools which simply went out and recruited students solely for the purpose of having Government pay educational benefits with no expectation that the student would ever appear at the school, or certainly stay there for the full course of his education to a situation in which there has been a legitimate attempt to have a student enroll and obtain financial aid, but then a failure to repay the Government when the student drops out at a later date, through problems involving just the financial security of the institutions themselves, theft directly from the student financial aid funds in institutions.

Whether we find anything that is comparable to the West Coast Trade Schools situation. I would suspect not anything quite as egregious as that. But the basic systemic problems that gave rise to the West Coast Trade Schools case are evident to some degree in Texas as well.

Senator PERCY. In your statement you indicate that the task force work has already resulted in 13 convictions of school officials, HEW employees, and others, and that ten indictments are pending. How many cases do these indictments and convictions actually represent?

Mr. RUFF. I do not have an exact number of cases in which these convictions were obtained. I will be glad to find out and submit them to you.

Senator PERCY. We will then, without objection, keep the record open so this can be provided.

[Additional material subsequently supplied by Mr. Ruff follows:]

The indictments and convictions involve four separate cases. The ten pending indictments were, in actuality, anticipated indictments which concerned individuals connected to a number of schools under common ownership.

The attached letter concerns the most recent action taken relative to "LTV".

A description of the four cases is also attached for your information.

U.S. DEPARTMENT OF JUSTICE,  
U.S. ATTORNEY,  
NORTHERN DISTRICT OF TEXAS,  
Dallas, Tex., August 1, 1978.

Re: LTV.

Mr. LAWRENCE LIPPE,

*Assistant Inspector General for Investigations, Department of Health, Education, and Welfare, HEW North Building, Washington, D.C.*

DEAR MR. LIPPE: Fifty-five Count Indictment against the LTV Corporation, Vought Corporation and LTV Education System, Inc. was returned by a Federal Grand Jury for the Northern District of Texas, July 31, 1978. Within an hour after the return of the indictment, pursuant to a plea bargain agreement, The LTV Corporation plead nolo contendere to Count 1, conspiracy to defraud and to file false claims. Vought Corporation plead nolo contendere to Count 1. LTV Education Systems, Inc. plead nolo contendere to Count 1 (§371), Counts 8-53 (§287) and Count 54 (§1001). All other counts will be dismissed upon the Court's acceptance of the plea and plea bargain and the payment of \$500,000.00

in fines, payment being guaranteed by The LTV Corporation and Vought Corporation.

Very truly yours,

KENNETH J. MIGHELL,  
U.S. Attorney.  
ROBERT C. PRATHER,  
U.S. Attorney.

Attachment.

The four cases of reference are as follows:

1. Ted R. Day, owner/operator of Draughon's Business Colleges of Lubbock and Amarillo, Texas and Commercial College of Lubbock, Texas, was indicted in May, 1976 for embezzling \$197,400 in Public funds. Day had, from February 1, 1974 until March 1, 1976, misused funds from the MDSL, BEOG, SEOG and CWS-P student loan programs.

Day pleaded guilty to the charges in May 1976 and was sentenced that month to five years imprisonment and five years probation.

2. Name: Richard Lee Willis; James C. Williams, Stanley Herman Dennis, et al.

San Antonio Commercial College, owned by above subjects, failed to refund tuition to students after they dropped out of classes. Instead they conspired to sell their promissory notes to banks where they would be defaulted. They prepared "Lenders Manifest for Federally Insured Student Loans" and included false information as to the attendance of the students.

Above named subjects indicted and convicted 18 USC 371 (conspiracy) 1001 and 1014. One pled and two were tried. Two subjects received five years probation sentences—one received five years imprisonment; appeal pending—proven loss estimated at \$900,000.

3. Name: Draughon's Business College, Lubbock, Tex. Alleged Fraud in Student Loan Programs.

Office of Education and HEW Audit Agency reviews of student loan and grant accounts at a proprietary business school indicated misuse of funds.

OI investigation reflected that the former owner of the school had diverted over \$450,000 from the BEOG, SEOG, FISL, and CWS programs to his own use.

The former owner was convicted of embezzlement in 1976 and sentenced to four years imprisonment and five years probation. He remains free on appeal. In August, 1977, HEW recovered \$634,144 through civil judgment.

4. Arnold Gene Tate, Former President, Collegiate Recovery and Credit Assistance Programs, Inc., which collected outstanding student loans, was charged 6/3/76 with embezzling \$200,000 public money, from 63 colleges and universities. Convicted 9/17/76, affirmed on appeal, 5/2/78.

Cecil Dwayne Evans, former Deputy Director, OGSL, Dallas RO, was charged with bribery of a public official, compensation to a Federal employee and interstate transportation in aid of racketeering. Convicted 9/17/76.

Arnold Gene Miller, former HEW employee was charged with aiding and abetting in the embezzlement of public money, bribery of a public official and destruction of records. Convicted 9/17/76.

Also charged with embezzlement are Thomas Foley III and Charles Edward Gent, Jr. Convicted 9/17/76.

James Phillip Kirchoff, HEW collector, convicted extortion on 6/3/76.

James Patten, HEW collector convicted 8/10/76 for impersonation of U.S. Attorney and U.S. Marshall.

James Watts, convicted of false statement on application for employment with HEW. Convicted 9/3/76.

All HEW employees formerly worked for Collegiate Recovery and Credit Assistance Programs, Inc.

Senator PERCY. How much do you expect to recover as a result of the task force work?

Mr. MORRIS. We do not know yet, sir. We are documenting the results as they occur. It will be a matter of months before we have a total record available.

Senator PERCY. You have no ball-park figures at all?



Mr. MORRIS. It would be just pure speculation, but millions of dollars are at stake.

Senator PERCY. In 1976 Senator Nunn and I sponsored legislation to provide criminal penalties for the types of activities exposed in the *West Coast Schools* case. Has that legislation, which was eventually enacted into law, been of any assistance to you in your work?

Mr. RUFF. I think it has been of direct assistance, Senator. Indeed, the ability to bring clear and direct criminal sanctions for misuse of the student aid programs has tremendously simplified the task of the prosecutors in this area.

I know they view it as a singular achievement. They do not in fact have to worry about whether some violation would fit into some other technical aspect of the Penal Code. They do have the direct basis for prosecution in these cases.

Senator PERCY. I would like to quote briefly from another section of your report, on page 55, you state:

The Office of Education's process for establishing school eligibility to participate in Federal aid programs does not assure that consumer protection and Federal interests are being protected. Weaknesses have been identified in each of the groups having oversight of schools—the States, the Federal Government, and the accrediting associations.

OE is preparing to establish separate additional criteria for these institutions which participate in the Student Financial Assistance programs. These criteria will be directed at the institution's management and fiscal capabilities for the operation of these programs.

You also state that "One million loan accounts are in default, representing a debt to the Federal Government of approximately \$1 billion." It is my understanding institutions often report loans as in default status without diligently attempting to collect from the borrower. Do you think that certain strict procedures should be followed by lenders before the Federal Government assumes payment of the outstanding balance?

Mr. MORRIS. The first statement that you read refers to the program that the new Bureau of Student Financial Assistance is developing to conduct periodic certification of each participating institution; of whom there are some 8,000 to 9,000. That is beginning this fall, and will be done on a regular basis. In addition, we are going to step up the audit attention to all of these schools requiring periodic independent audits. We think the visibility and discipline of these techniques is going to be very significant.

As to the loan programs, this is perhaps the number one priority that the Bureau has given in its first year. We do expect the lenders to exercise due diligence before they turn over the cases to us for collection. That will be taken into account as we do these audits and certification reviews.

Senator PERCY. Could you refresh my recollection? Are these 100 percent guaranteed, or is there a liability on the part of the bank if they do not collect as in SBA loans?

Mr. MORRIS. The Government GSL program is a completely Government-financed effort. The State guarantee agencies are reinsured by the Federal Government to the extent, I believe, of 80 percent.

Senator PERCY. Isn't that one of the problems with it, that there isn't the real incentive on the part of the lender to really diligently collect, because his risk is zero?

Mr. MORRIS. I think much can be said for that point.

Senator PERCY. Should schools with questionable financial histories of resources be bonded, especially for proprietary institutions, like for West Coast Schools?

Mr. RUFF. I really don't feel I am capable of answering that with any particular expertise, other than I take it any bonding institution would look askance on an organization that had a history of theft or defalcation of one kind or another.

Senator PERCY. When you mentioned the guidelines, would it be your feeling that we should establish legislation that would explicitly set guidelines and codify them?

Mr. MORRIS. Sir, I am not enough of an expert in the whole legislative background to offer a proper opinion. I can say that new regulations are being developed around each of the several student financial aid programs at this time and are appearing in the Federal Register currently.

I think a great deal of progress is being made and as far as I know, the legislation is adequate to support them.

Senator PERCY. Should regular attendance reports on student borrowers be sent to lending institutions directly so that these institutions can protect their own financial interests?

Mr. MORRIS. The attendance monitoring question is one that we have recently become aware of. It is a very complex matter. I don't frankly know what the answer is today. In many universities today attendance is not even kept track of. It is very difficult to know when students drop out.

Senator PERCY. Going back to the guidelines, even though you disclaimed your own expertise in the legislative area, would it be possible for the Department to give us a judgment as to whether or not legislation in this area of codifying guidelines would not be desired?

Mr. MORRIS. We will be glad to.

[The information to be furnished follows:]

Currently, several efforts are underway to provide both an oversight and alert system on problems relating to financial integrity and stability of educational institutions participating in Federal Student Financial Aid Programs. A Division of Certification and Program Review has been established in the BSFA which will provide oversight on eligibility to participate in these programs and to monitor prospective problem school situations. It is expected that these efforts will go a long way to prevent some prior abuses that have been identified.

Federal regulations have also been published to tighten up matters in this area and copies are attached for your information. These regulations established standards of financial stability and institutional capability for school participation in Student Financial Aid Programs. These regulations are based on the Higher Education Act of 1965, Education Amendments of 1976, Section 497 A (a) (2).

A copy of the Notice of Proposed Rulemaking, "General Provisions Relating to Student Assistance Programs", (45 CFR Part 168) is attached for your information. They are scheduled for publication in the Federal Register this week.

## DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

## Office of Education (45 CFR Part 168)

## GENERAL PROVISIONS RELATING TO STUDENT ASSISTANCE PROGRAMS

Agency: Office of Education, HEW.

Action: Notice of Proposed Rulemaking.

Summary: This document proposes, in Subpart B, minimum standards regarding audits, financial responsibility and administrative capability which an otherwise eligible postsecondary institution or school must meet to participate in the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965.

Subpart C proposes rules dealing with institutional misrepresentation of the nature of its educational program, its financial charges or the employment of its graduates. The Commissioner of Education believes that institutional adherence to the requirements of the proposed rules will result in improved management of Title IV student financial assistance funds.

Dates: Comments must be received on or before (45 days after publication). It would be extremely helpful if the comments refer to specific sections and are made sequentially.

Public hearings on these proposed regulations will be held in six cities at the addresses listed below. The date and time for each meeting is as follows:

September 11, 1978—Atlanta, Georgia, and Boston, Massachusetts, 10 a.m.

September 12, 1978—Dallas, Texas, and Chicago, Illinois, 10 a.m.

September 14, 1978—San Francisco, California, 10 a.m.

September 15, 1978—Washington, D.C., 10 a.m.

Addresses: Written comments should be sent to: Mr. William L. Moran, Division of Policy and Program Development, Basic Grants Branch/Policy Section, Room 4923, ROB 3, 400 Maryland Avenue, S.W., Washington, D.C. 20202. Comments will be available for public inspection in Room 4923, Regional Office Building 3, 7th & D Streets, S.W., Washington, D.C. from 8:30 a.m. to 4:00 p.m. Monday through Friday (except Federal Holidays).

The public hearings will be held at the following locations:

September 11, 1978—Atlanta College of Art, Memorial Art Center, The Panel Room, 1280 Peachtree Street N.E., Atlanta, Ga.; 10 a.m.

September 11, 1978—Boston University, Harold P. Case Physical Education Center, Eilberg Lounge, Babcock and Commonwealth Avenues, Boston, Mass.; 10 a.m.

September 12, 1978—University of Texas, Health Science Center, Building D1.600, 5323 Harry Heines Boulevard, Dallas, Texas; 10 a.m.

September 12, 1978—University of Chicago, Cobb Hall, Quantrell Hall Auditorium, 5811 South Ellis Avenue, Chicago, Ill.; 10 a.m.

September 14, 1978—University of San Francisco, University Center, Room 413, 2130 Fulton Street, San Francisco, Ca.; 10 a.m.

September 15, 1978—Regional Office Building 3, GSA Auditorium, 7th & Streets, S.W., Washington, D.C.; 10 a.m.

To facilitate scheduling of speakers it would be helpful if any person desiring to present his or her views orally at any of the scheduled hearings would inform the appropriate representatives listed below in advance of the hearing. If a prepared statement will be presented, the presenter is requested to file three copies with the representative either prior to or on the date of the hearing.

Ms. Judith Brantley, U.S. Office of Education, 101 Marietta Tower, Third Floor, Atlanta, Georgia 30323, (404) 242-5010.

Mr. Thomas J. O'Hare, U.S. Office of Education, P.O. Box 8370, John F. Kennedy Federal Building, Boston, Massachusetts 02114, (617) 223-7205.

Ms. Carol Sivright, U.S. Office of Education, 1200 Main Tower Building, Dallas, Texas 75202, (214) 729-2221.

Mr. Donald Aripoli, U.S. Office of Education, 300 South Wacker Drive, Chicago, Illinois 60606, (312) 353-2508.

Mr. Jerry Craft, U.S. Office of Education, 50 United Nations Plaza, San Francisco, California 94102, (415) 556-0137.

Mr. William Moran, U.S. Office of Education, 400 Maryland Avenue, S.W., Washington, D.C. 20202, (202) 245-1744.

For further information contact: Mr. William Moran, (202) 245-1744.  
Supplementary information:

#### NEED FOR REGULATION

The major student financial assistance programs administered by the Office of Education, namely Basic Grant, Supplemental Grant, College Work-Study, Guaranteed Student Loan and National Direct Student Loan Programs, provided financial support to approximately 2.7 million students in the 1977-78 academic year. The loans made or insured under the Guaranteed Student Loan Program amounted to over \$1 billion, the grants awarded under the Basic Grant program amounted to over \$1.7 billion, and approximately \$1 billion has been disbursed under the three campus based programs. For the 1978-79 academic year, financial assistance under these programs will, it is anticipated, amount to approximately \$3.7 billion.

As a result of the magnitude of this assistance and the rising concern over the misuse and abuse of these Federal student financial aid programs by institutions and schools, and the rise in the default rate for the Guaranteed and National Direct Student Loan programs, the Congress in the recently enacted Education Amendments of 1976, P.L. 94-482, authorized the Commissioner of Education to, prescribe such regulations as may be necessary to provide for—

(1) A fiscal audit of an eligible institution with regard to any funds obtained by it under Title IV programs or obtained from a student who has a loan guaranteed or insured under Title IV; and

(2) The establishment of reasonable standards of financial responsibility and appropriate institutional capability for the proper administration by an eligible institution of Title IV student financial aid programs.

Prior to the enactment of this section (Section 497A of the Higher Education Act), the Commissioner's specific authority to prescribe standards was restricted to institutional participation in the Guaranteed Student Loan Program.

The statute also provides that the Commissioner may suspend or terminate an institution's participation in Title IV programs upon a determination that it has engaged in substantial misrepresentation of the nature of its educational program, its financial charges, or the employability of its graduates.

As background for these provisions, the House Report leading to the Education Amendments of 1976 discussed the need for the provisions, stating that:

"The bill also includes provisions that will increase the level of accountability for student assistance funds that are obtained directly or indirectly by an institution of higher education \* \* \* \* These additions to current law are intended by the Committee to provide the Commissioner with the necessary tools to keep unethical individuals from engaging in unlawful conduct and sharp practice in the name of helping financially disadvantaged students to obtain the education necessary to succeed in the economy of the '70s." H. Rep. No. 1086, 94th Congress 2nd Sess. p. 13.

In the same vein, the Senate Report stated:

"The Education Amendments of 1972 authorized the Commissioner to limit, suspend, or terminate institutional participation in the Guaranteed Student Loan Program, in a provision similar to that in the Committee bill. After a number of years, the Office of Education has finally issued regulations to implement that provision, and the Committee hopes that it will have a significant effect in weeding out those schools which do not have the fiscal stability or administrative competence to participate successfully in the loan program. The Committee bill would extend this protection to the Basic Grant, Work-Study, and Direct Student Loan Programs.

"Without the language of the Committee bill, the Commissioner has no statutory authority to withhold payments from a school that he knows is foundering and will not be able to provide its students their education, after its cost has been paid. It makes little sense to the Committee to require continued payment of Federal funds to an institution in financial crisis, which threatens to close its doors and leave its enrollees stranded. The Committee bill would allow the Commissioner to set fiscal standards, then suspend, limit or terminate an institution's participation if it failed to meet them, after notice and hearing." S. Rept. No. 94-882, 94th Cong. 2nd. Sess. p. 33.

Some of the specific concerns that gave rise to these provisions were reported in an Office of Education sponsored study, completed in October 1976 by the American Institutes of Research. That study revealed that misleading recruiting and admission practices, misleading advertising, lack of institutional financial stability, lack of adequate record keeping practices, inequitable refund policies and the failure to make timely tuition and fees refunds were some of the more prevalent institutional abuses that affected the integrity and effectiveness of the aid programs.

Another major concern giving rise to these statutory provisions was the increase in the default rate in the National Direct and Guaranteed Student Loan Programs. For example, Federal obligations to cover loans defaulted under the Guaranteed Student Loan Program soared from \$31 million in 1972 to \$177.5 million in 1976, representing nearly a sixfold increase during a period when loan volume remained relatively stable.

The Commissioner has proposed the standards set forth in this regulation (1) to curb and hopefully eliminate fraud and abuse in the Title IV student assistance programs by institutions, schools and students, and (2) to increase the level of accountability for student assistance funds administered by institutions of higher education and vocational schools.

The proposed standards for administrative capability, which were developed with the assistance of the HEW Audit Agency, reflect the practices and policies being followed by institutions which have sound procedures for the administration of Title IV programs and should serve to assist other schools in developing good procedures. The standards, therefore, set forth a model set of procedures and establish parameters within which appropriate institutional policies may be drafted and implemented without Federal intervention. The standards of financial responsibility are intended to assure that an institution will be financially able to provide the education that its students have paid for.

When these rules go into effect, all institutions must comply with the requirements contained in them. The Commissioner anticipates that over a three-year period each institution already participating in any of the Title IV programs will be reviewed to determine whether the institution complies with these requirements. Institutions seeking eligibility will be evaluated in terms of these requirements before they are determined eligible for Title IV programs. For the new institutions and for the institutions already eligible who are the first to be reviewed, compliance will be based primarily on the establishment of appropriate policies and procedures. However, after a reasonable period, the Commissioner will evaluate currently eligible institutions, and will reevaluate new institutions and those currently eligible institutions that were the first to be reviewed, on the basis of actual performance. Thus, for example, a consistent failure by an institution over an extended period to properly calculate student awards would indicate that the institution does not, in fact, have adequate personnel to administer student financial aid funds, as required by Section 168.15.

The following is a discussion of the major provisions of the proposed regulation.

#### *Audits and recordkeeping*

The regulations do not set forth any new audit requirements but cross-reference requirements already contained in existing program regulations. With respect to records, the only major new requirement is that institutions keep admission records that reflect the education and other relevant qualifications of each student admitted. (Section 168.12(c)). These records are necessary to enable the Commissioner to determine whether the institution satisfies the statutory definition of an institution of higher education, proprietary institution of higher education, or vocational school. For example, such records would show whether non-high school graduates admitted to a public junior college have the ability to benefit from the training offered, and whether that student is above the age of compulsory school attendance.

Additionally, institutions would be required to maintain a separate bank account for Federal funds received under the National Direct-Student Loan, College Work-Study, Supplemental Educational Opportunity Grant, and Basic Educational Opportunity Grant programs which are to be disbursed to students. This regulation would supersede the current program regulations which provide

that physical segregation of cash depositories for Federal student aid funds is not required. In accordance with current practice, however, separate bank accounts would not need to be maintained for each individual program, provided adequate fiscal records for each program are maintained.

Another new requirement is that institutions make records readily available for review at the geographical location where students will receive their degree or certificate. Thus multi-campus institutions do not have to keep records at each branch campus. However, when requested, they must make such records available at the particular institution being reviewed by the Commissioner.

#### *Factors of financial responsibility*

The standards regarding financial responsibility (Section 168.14) are formulated to assure that a student who enrolls at an institution or school will receive the education he is paying for. The bonding requirement is proposed in response to several incidents where student assistance funds were embezzled by employees of an institution.

Institutions are accountable to the Federal government for any loss of funds as a result of the funds being stolen or embezzled by school employees. The proposed regulation would require institutions to bond each individual disbursing Title IV funds in an amount equal to 10 percent of funds disbursed by the institution each academic year. Thus the proposed regulation would provide protection to the institution as well as the Federal government. Because of the cost of bonding, it was decided to limit the bonding to 10 percent of the funds disbursed.

Performance bonding was considered, but upon investigation, this requirement was not retained because its cost would be prohibitive.

#### *Administrative capability*

With regard to one of the requirements contained in this section (Section 168.15) that an institution use "an adequate number of qualified persons" to administer program funds, the Office of Education invites particular comment as to what would constitute an "adequate" number of such personnel and what factors should be considered in making this determination.

The Education Amendments of 1976 set forth a new requirement: that students must maintain satisfactory academic progress according to the standards and practices of the institution (Section 497(e) of the Higher Education Act). The Commissioner will include in his determination of an institution's capability to administer Title IV funds, whether the institution has established and applies "reasonable" standards in measuring satisfactory progress of student aid recipients. The purpose of this provision is to cope with the so called "professional" student and students who attend school only to obtain financial aid.

#### *Institutional refunds*

One means of measuring whether an institution is capable of administering Title IV funds and is financially responsible to its students is by examining its refund policy. This notice of proposed rulemaking does not include proposed regulations concerning institutional refund policies. Rather, through this notice the Commissioner of Education is soliciting public comment on the subject before any proposed regulations are drafted. Commenters are requested to bring to our attention examples of institutional abuse of Federal student aid programs, if any, which they believe have been caused by an institution's refund policy or lack thereof. Commenters should also indicate whether they feel such abuses could be curbed by regulations, and, if so, what requirements those regulations should contain. All comments received on this issue will be studied carefully before any proposed regulations are drafted and submitted for public comment. (It should be noted that the institution's refund policy is included in §178.4 of the Student Consumer Information Services regulations (45 CFR 178.4) as one of the items on which information is to be made available to students.)

#### *Attribution of institutional refund, and repayments of cash disbursements made directly to the student*

1. Attribution of Institutional Refund. When a student's institutional charges were paid with funds from Title IV programs, other than the College Work-

Study Program, any institutional refund must be apportioned among the various sources of funding which were used to pay the charges originally. Paragraphs (a) through (c) of §168.17 deal with the method of computing this apportionment. Since a student is not expected, of course, to return earnings for work performed, the issue of apportionment of the institutional refund concerns only the grant and loan portions of the student's package which had been awarded to meet costs for an entire term or payment period.

Two methods of computing the apportionment of the institutional refund were considered in drafting the proposed regulation. They differ primarily in their treatment of the expected family contribution. The first method assumes that the expected family contribution and the various components of the student's aid package are expended at the same rate in meeting the student's educational costs. The second method, applying the principle that any need-based financial aid is supplemental to the expected family contribution, assumes that the family contribution is expended fully before any financial aid funds are used.

Thus, under the first method a portion of the refund will be attributable to the expected family contribution whenever there is an expected family contribution of any amount. Under the second method a portion of the refund would be attributed to the family contribution only when the amount of the refund exceeded the amount of the grant and loan portions of the student's aid package.

In drafting the proposed regulation, the Commissioner has adopted the first method. However, he is soliciting comments on the alternative as well as on the method set forth in the proposed rule.

The method set forth in §168.17 of the proposed rule assumes that the family contribution and each of the grant and loan components of the student's aid package were applied toward the student's educational costs in the same proportion that each represents as part of an aggregate amount. Therefore, the institutional refund is allocated among these various funding sources in proportion to their original share of the aggregate.

The following example shows the apportionment of an institutional refund of \$500 in a case in which the family contribution plus the grant and loan portions of the aid package totaled \$2,000.

Funding	Cost	Percent of cost	To—	Allocation of refund
Family contribution.....	\$450	22.5	Student.....	\$112.50
BEOG.....	250	12.5	BEOG account.....	62.50
SEOG.....	750	37.5	SEOG account.....	187.50
Loan (NDSL or GSL).....	550	27.5	Loan account.....	137.50
Total.....	2,000	100.0		500.00

NOTE.—In the case of a national direct student loan, the portion of the refund attributable to the loan would be applied as a reduction of the principal balance in the student's loan account at the institution. In the case of a guaranteed student loan, the portion of the refund attributable to the loan would be paid by the institution to the lender.

The alternative method assumes that the family contribution should be expended in its entirety before any student financial aid funds are expended. Thus, student-owned refunds are attributed to the various nonwork sources of financial aid until the original amounts have been completely restored before any funds are returned to the family. If the amount of money being refunded exceeds the amount of non-work financial aid which was provided to the student and to the student's account, the excess is returned to the family. On the other hand, if the amount of money being refunded is equal to or less than the amount of non-work financial aid provided to the student or to the student's account, the entire amount being refunded is allocated among those sources of aid in proportion to their shares of the original aggregate amount of non-work financial aid provided to the student or to the student's account.

In the example cited below, using the same figures as in the previous example, the cost is \$2,000, the grant-loan components of the student's aid package totaled \$1,500, and the institutional refund was \$500. Therefore, the entire amount of the institutional refund would be allocated to the appropriate student aid accounts in the following manner:





**CONTINUED**

**1 OF 2**

Funding source	Grant loan components	Percent of total grant/loan aid	To—	Allocation of refund
BEOG.....	\$250	16.1	BEOG account.....	\$80.50
SEOG.....	750	48.4	SEOG account.....	242.00
Loan (NDSL or GSL).....	550	35.5	LOAN account.....	177.50
Total.....	1,550	100.0		500.00

<sup>1</sup> In the case of a national direct student loan, the portion of the refund attributable to the loan would be applied as a reduction of the principal balance in the student's loan account at the institution. In the case of a guaranteed student loan, the portion of the refund attributable to the loan would be paid by the institution to the lender.

Under the first method described above, the student is due a portion of the institutional refund resulting from an unexpended portion of the expected family contribution. However, under the following circumstances the student may not receive any money.

As discussed under item 2 below, a student may have received an overpayment of aid funds as a result of receiving a cash disbursement for noninstitutional charges. In such a case the amount due to the student from the institutional refund would be applied against that overpayment before any of these funds were returned to the student.

In applying for a Guaranteed Student Loan, the student may have agreed to assign a portion of a refund due to him or her to the lender for reduction of the principal balance of the loan. Therefore, even though the student did not owe a repayment of a cash disbursement for noninstitutional charges, the portion of the refund attributable to the expected family contribution might not be returned to him or her since it may be assigned to the lender to reduce the principal Guaranteed Student Loan balance. Thus, the student would not receive a cash refund from the institution until all overpayments were settled and any amount assigned to reduce a Guaranteed Student Loan balance had been returned by the institution to the lender.

Under the alternative method, offsets resulting from an unexpended portion of the expected family contribution would usually not occur, and the student would owe back to the institution a larger portion of the financial aid disbursed to him or her for living expenses.

## 2. Attribution of repayments of cash disbursements made directly to the student

Paragraph (d) of §168.17 is intended to provide a means of determining if a repayment is due from any cash disbursement of aid for noninstitutional charges if the student leaves that institution before the end of the payment period for which the cash disbursement was made.

In determining whether a repayment is due, the institution will, of course, need to know the date the student left the institution. If the student officially withdrew or was expelled, the date he or she ceased to be in attendance will be a matter of institutional record. If the student simply left the institution without completing official withdrawal procedures (i.e., unofficially withdrew) and no specific date for his or her departure is known, the institution should use its best judgment in determining the date the student ceased to be in attendance in order to compute the portion of a cash disbursement which should be considered as already expended during his or her period of attendance.

The proposed regulation provides that the institution itself shall determine the amount of the total cash disbursement which should be considered "unused" as of the date the student leaves the institution, taking into consideration reasonable expenses which the student would have incurred during his or her period of attendance for items which were not paid to the institution. (It is assumed that any institutional refund policy would take into account any amounts paid to the institution in cash as well as amounts credited to the student's institutional account.) The proposed regulation cites a number of types of expenditures which could be considered but does not limit the institution's discretion to include others. After the institution has determined the total amount of the cash disbursement which it considers unused as of the date the student ceased to be in attendance, the portion of the overpayment to be attributed to each grant and loan program shall be made in accordance with the following ratio:

Amount to be attributed to each program	Amount provided by each program for the period for which aid was awarded
Total amount of cash disbursement determined by the institution to be an overpayment	Student's cost of education for the period for which aid was awarded, minus amount of student earnings during the period

This procedure parallels that set forth in §168.17(a) for determining the attribution to program accounts of an institutional refund. Expressed as equation, the ratio appears as:

$$\text{Amount to be attributed to each program} = \frac{\text{Amount provided by each program for the period for which aid was awarded}}{\text{Student's cost of education for the period for which aid was awarded, minus amount of student earnings during the period}} \times \text{Total amount of cash disbursements determined by the institution to be an overpayment}$$

On April 8, 1977, a Notice of Proposed Rulemaking was published in the *Federal Register* which discussed the issue of attribution of repayments from cash disbursements made directly to the student when the student leaves the institution before the completion of the period for which the funds were awarded. In that notice a formula was proposed, to be inserted in §176.14 of the Supplemental Grant regulations and §190.77 of the Basic Grant regulations, for calculating the portion of a grant disbursement which should be considered an overpayment subject to repayment by the student. There was a general consensus among the commenters that the formula did not allow sufficient flexibility for the institution to take into consideration the circumstances of individual students in determining the amount of a cash disbursement which should be repaid. In response to the commenters' concern, the proposed formula has been discarded. In its place we have substituted the procedure set forth in §168.17(d), and described above, in which the institution has discretion in determining the portion of a cash disbursement which it considers "unused" as of the date the student withdraws. The portion of the "unused" amount which should then be considered an overpayment for each specific grant program is then determined by the simple proportionate ratio set forth in the regulation.

#### *Additional factors*

Section 168.18 sets forth conditions which the Commissioner views as warning signals regarding whether an institution is capable of continuing its participation in Title IV programs. This section is based upon section 177.66 of the existing GSL program regulations. (45 CFR 177.66) However, the benchmark default and withdrawal rates have been revised upward and the default provision has been extended to include National Direct Student Loans as well as Guaranteed Student Loans.

An additional distinction should be made between factors of financial responsibility contained in Section 168.14 and those additional factors for evaluating administrative capability and financial responsibility found in Section 168.18.

The items contained in Section 168.14 are conditions which an institution must meet in order to gain or maintain program eligibility. Failure to meet these provisions will be grounds for refusal to allow initial program participation or for the initiation of Limitation, Suspension and Termination actions. Failure to meet the requirements of Section 168.18 may be grounds for denial or Limitation, Suspension and Termination actions at the Commissioner's discretion; and the Commissioner may require corrective action before extending program eligibility.

#### SPECIFIC COMMENTS AND RESPONSES

In October, 1976, the Congress enacted and the President signed into law the Education Amendments of 1976. On November 29, 1976, the Commissioner published in the *FEDERAL REGISTER* (41 FR 52417) a Notice of Intent to Issue Regulations in order to solicit early public participation in the rule-making process.

Five public conferences were held across the country between December 13 and 17, 1976, and comments made at those conferences were considered in developing the proposed rule. Written comments were also received through December 30, 1976 and were considered in the development of this proposed rule. The following is a summary of these comments and the Commissioner of Education's response.

*Comment:* One commenter said that an audit should not be so comprehensive as to verify the propriety of each Federal dollar an institution spends. It should, however, be sufficiently comprehensive to establish that financial control systems are adequate and functioning effectively and that the institution is in compliance with Federal law and regulations.

*Response:* The Commissioner agrees. The proposed rule provides that audits are to be conducted in accordance with applicable Title IV program regulations and audit guides.

HEW audit guides are presently available for the Supplemental Educational Opportunity Grant, College Work-Study, and National Direct Student Loan Programs. The Office of Education anticipates that an audit guide will be available for the Basic Educational Opportunity Grant Program by the time these proposed rules are published as final regulations. No audit guide is presently being contemplated for the Guaranteed Student Loan Program.

*Comment:* Comments received relative to the desirable frequency of fiscal audits ranged from annual to two, three or five years. Additionally, special audits were recommended whenever (i) there was a change in ownership, (ii) the institution was the subject of continued complaints by student consumers, or (iii) there was evidence that funds were being misused. One commenter suggested that the Inspector General of DHEW be authorized access to all fiscal records of an institution at any time.

*Response:* Under existing Title IV program regulations, audits are to be conducted at least once every two years. The proposed regulations provide that this frequency be maintained under normal circumstances.

The Inspector General has access to all relevant records under Section 205 of Public Law 94-505.

*Comment:* Several commenters suggested that audit standards (i) parallel the American Institute of Certified Public Accounts (AICPA) Audit Guide, (ii) be mutually agreed upon by HEW and the National Association of Colleges and University Business Officers (NACUBO) and (iii) follow the standards for *Audit of Governmental Organizations, Programs, Activities and Functions* (GAO), and the *Accounting, Recordkeeping and Reporting by Colleges and Universities for Federally Funded Student Financial Aid Programs*, HEW, 1974.

*Response:* The regulation proposes that audits be conducted in accordance with the *Standards for Audits of Government Organizations, Programs, Activities and Functions* (GAO), and the existing Title IV program regulations. As noted above the HEW Audit Agency has developed audit guides which were developed in association with the American Institute of Certified Public Accountants for the college based programs.

*Comment:* Relative to standards of financial responsibility and institutional capability, one commenter recommended that institutions be required to have the capability of meeting all reporting requirements and maintain supporting documentation for all awards.

*Response:* The regulations set, as a condition of eligibility, requirements for an institution's recordkeeping capability, including a requirement that it keep systematically organized records relating to all Title IV transactions.

*Comment:* Relative to who is to conduct required audits, several commenters made the following recommendations: (1) That audits be performed by the university system of auditors when an institution is associated with such a public system or, in the case of institutions not associated with a public system, by HEW auditors; and (2) That audits be conducted by the institution using CPA firm and Federal guidelines.

*Response:* The regulation permits the institution to choose who is to conduct audits. It requires only that the individual chosen be sufficiently independent of those who authorize the expenditure of Federal funds and that the individual comply with the GAO *Standards for Audit of Governmental Organizations, Programs, Activities, Functions*, and existing Title IV program regulations.

*Comment:* One commenter recommended that non-public institutions should be required to post a bond sufficient to assure performance.

*Response:* The Commissioner disagrees. Performance bonding was found to be prohibitively expensive. However, the Commissioner has required a bond on personnel handling Title IV funds to the extent of 10-percent of the Title IV funds disbursed by an institution in an academic year.

*Comment:* Several comments were received concerning possible misrepresentation by an institution of the nature of its educational program, its financial charges or the employability of its graduates. One commenter suggested that the audit should be comprehensive enough to demonstrate that the institution had (i) clearly stated and measurable objectives, (ii) the capacity and resources to meet those objectives, and (iii) sufficient financial stability to give some protection to the student consumer.

*Response:* The suggestion with respect to (i) and (ii) cannot be adopted since the Commissioner's statutory authority is restricted to the administration and financial responsibility of student aid programs under Title IV. One commenter suggested that the term "misrepresentation" need not be defined. Another suggested that a definition of the term include misrepresentations such as the listing of fields of study not actually offered by the institution, or descriptions of facilities and services that do not exist.

*Response:* The Commissioner believes that a definition is necessary and has defined both the terms "misrepresentation" and "substantial misrepresentation" in §168.32. The Commissioner has also addressed the concerns suggested by the second comment in §168.33.

*Other Information:* The Office of Education has determined that this document does not contain a major proposal requiring preparation of an Inflation Impact Statement under Executive Order 11821 and OMB Circular A-107.

Dated: January 27, 1978.

ERNEST L. BOYER,  
*U.S. Commissioner of Education.*

Approved: July 22, 1978.

HALE CHAMPION,  
*Acting Secretary of Health, Education, and Welfare.*

Chapter I of Title 45 of the Code of Federal Regulations is amended by adding Part 168 to read as follows:

#### PART 168—GENERAL PROVISIONS RELATING TO STUDENT ASSISTANCE PROGRAMS

##### SUBPART A—GENERAL

###### *Sec.*

168.1 Scope and purpose.

168.2 Definitions.

##### SUBPART B—STANDARDS RELATING TO AUDITS, RECORDS, FINANCIAL RESPONSIBILITY, ADMINISTRATIVE CAPABILITY AND INSTITUTIONAL REFUNDS

168.11 Scope and purpose.

168.12 Audits, records and examination.

168.13 Audit exceptions and repayments.

168.14 Factors of financial responsibility.

168.15 Standards of administrative capability.

168.16 [Reserved]

168.17 Attribution of institutional refunds.

168.18 Additional factors for evaluating administrative capability and financial responsibility.

##### SUBPART C—MISREPRESENTATION

168.31 Scope and purpose.

168.32 Special definitions.

168.33 Nature of educational programs.

168.34 Nature of financial charges.

168.35 Employability of graduates.

168.36 Endorsements and testimonials.

168.37 Procedures.

Authority: Section 497A of the Higher Education Act of 1965, as added by Section 133 of Pub. L. 94-482, 90 Stat. 2150-2151 (20 U.S.C. 1088f-1), unless otherwise noted.

**SUBPART B—STANDARDS RELATING TO AUDITS, RECORDS, FINANCIAL RESPONSIBILITY, ADMINISTRATIVE CAPABILITY AND INSTITUTIONAL REFUNDS**

**§ 168.11—Scope and purpose**

This subpart sets forth standards which an otherwise eligible institution—that is, an institution of higher education satisfying the statutory definitions set forth in Sections 435(b), 491(b), or 1201(a) of the Higher Education Act (HEA) or a vocational school satisfying the definition in Section 435(c) of the HEA—must meet in order to participate in the student financial assistance programs authorized under Title IV of the Act. The standards concern the conduct of audits, the maintenance of records, financial responsibility, administrative capability and institutional refunds. Non-compliance with these provisions may subject an otherwise eligible institution to proceedings under Subpart II which may lead to a limitation, suspension or termination of its eligibility for Title IV programs. (20 U.S.C. 1088f-1)

**§ 168.12—Audits, records and examination**

(a) If an institution participates in the Supplemental Educational Opportunity Grant Program, 45 CFR 176, College Work-Study Program, 45 CFR 175, National Direct Student Loan Program, 45 CFR 144, Basic Educational Opportunity Grant Program, 45 CFR 190, or Guaranteed Student Loan Program, 45 CFR 177, it must comply with the regulations for those programs concerning (1) audits of institutional transactions, (2) record keeping, and (3) a separate bank account for Federal funds received under these programs.

(b) (1) Audits must be conducted by individuals who are sufficiently independent of those authorizing the expenditure of Federal funds to produce unbiased opinions, conclusions or judgments. The independence of these individuals shall be judged in accordance with the criteria set forth in Part III, Chapter 3 of the U.S. General Accounting Office publication, *Standards for Audit of Governmental Organizations, Programs, Activities and Functions*. Additionally, auditors other than employees of a State or local government must meet the qualifications criteria set forth in Appendix I of the GAO document. (These documents are included as Appendix A and Appendix B of this part.)

(2) Any individual or firm conducting an audit described in this section must give the Director of the HEW Audit Agency or the Commissioner access to records or other documents as may be necessary to review the results of the audits.

(c) (1) With respect to each Title IV financial aid recipient, an otherwise eligible institution must establish and maintain on a current basis student records regarding:

- (i) The student's admission to, and enrollment status at, the institution,
- (ii) The program and courses in which each recipient is enrolled;
- (iii) Whether the student is making satisfactory progress toward completion of the course of study the student is pursuing according to the standards and practices of the institution;
- (iv) Any refunds due or paid the student; and
- (v) The student's placement by the institution in a job if the institution provides a placement service and the student uses that service.

(vi) Amounts of financial aid from Title IV programs received by the student at the institution and at any institutions the student previously attended. The institution must provide a copy of this record to any institution to which the student transfers at the request of that institution or the student.

(2) (i) With respect to each student enrolled at the institution, an otherwise eligible institution must establish and maintain records regarding the educational qualifications of that student as they relate to the admissions requirements of the institution.

(ii) With respect to those institutions where the entire institution has not been determined eligible, the institution must establish and maintain records regarding the educational qualifications of each student as they relate to the admissions requirements of those particular programs which have been determined eligible.

(3) Records must be (i) systematically organized and (ii) readily available for review by the Commissioner at the geographical location where the students will receive their degrees or certificates of program or course completion.

(d) An institution must deposit all Federal funds it receives under the Supplemental Educational Opportunity Grant, College Work-Study, National Direct Student Loan, and Basic Educational Opportunity Grant programs in an account which does not include non-Federal funds or Federal funds from other programs. This account is subject to audit by the Commissioner at such reasonable times as the Commissioner will determine. (20 U.S.C. 1088f-1)

#### *§ 168.13 Audit exceptions and repayments*

(a) If the Hev Audit Agency questions an expenditure or the institution's compliance with any applicable requirements as a result of its own audit or an audit performed at the direction of the institution, the Agency notifies the Commissioner and the institution of the questioned expenditure or procedure. If the institution believes the expenditure or procedure was proper, it shall notify the Commissioner in writing of its position and the reasons therefor. The institution's response must be received by the Commissioner within thirty-five days of the date of the Audit Agency's notification to the institution.

(b) Based on the audit finding and the institution's response, the Commissioner will determine the amount of funds improperly spent, if any, and will instruct the institution as to the manner of repayment. The institution must repay those funds within 60 days of the Commissioner's notification, unless the Commissioner permits a longer repayment period.

(20 U.S.C. 1088f-1)

#### *§ 168.14 Factors of financial responsibility*

(a) An otherwise eligible institution must be financially able to—

(1) Provide the educational services stated in its official publications and statements;

(2) Provide the administrative resources necessary to comply with the requirements set forth under this subpart; and

(3) Meet all its financial obligations including refunds.

(b) An otherwise eligible institution must bond each individual disbursing Title IV funds at the institution in an amount equal to 10% of the Title IV funds disbursed by that institution each academic year.

(c) If the Commissioner has reason to believe that an institution is unable to meet the requirements set forth in paragraph (a) of this section, or if the institution changes ownership, the Commissioner may require the institution to submit for its latest fiscal year a financial statement or an audit prepared by a State or local audit agency for a public institution, or certified by a Certified Public Accountant or Licensed Public Accountant for a non-public institution. The financial statement must include a balance sheet and an operating statement (profit and loss statement covering both income and expenses).

(20 U.S.C. 1088f-1)

#### *§ 168.15 Standards of administrative capability*

In order to participate in a Title IV student financial aid program, an otherwise eligible institution must have the capability to adequately administer those programs. The Commissioner will consider an institution as having that capability if it establishes and maintains required student and financial records and if it:

(a) Designates a capable individual to be responsible for administering all the Title IV programs in which it participates;

(b) Uses an adequate number of qualified persons to administer those programs. In determining whether an institution uses an adequate number of qualified persons, the Commissioner will consider the number of students aided, the number and type of programs in which the institution participates, the number of applications evaluated, and the amount of funds administered;

(c) Administers Title IV programs in such a manner as to provide for an adequate system of internal controls. These internal controls must provide for a system of checks and balances under which no person will be directly responsible for all aspects of the programs. The functions of authorizing payment and disbursing funds shall be divided so that no office has the responsibility for both functions with respect to any particular student aided under the programs;

(d) Establishes and applies reasonable standards for measuring whether a student receiving aid under any Title IV program is maintaining satisfactory progress in the course of study the student is pursuing;

(e) Develops an adequate system to verify the consistency of the information it receives from different sources with respect to a student's application for financial aid under Title IV programs. In determining whether the institution has an adequate verification system, the Commissioner will consider whether the institution reviews:

(1) All student aid applications, needs analysis documents, and eligibility notification documents presented by or on behalf of each applicant;

(2) Any documents, including any copies of State and Federal income tax returns which are normally collected by the institution to validate information received from other sources; and

(3) Any other information normally available to the institution which bears on a student's citizenship, previous educational experience or other factors relating to a student's eligibility for Title IV funds; and

(f) Provides adequate financial aid counseling to eligible students who apply for Title IV aid. In determining whether an institution provides adequate counseling, the Commissioner will consider whether its counseling includes information regarding:

(1) The source and amount of each type of aid offered;

(2) The method by which aid is determined, and disbursed or applied to a student's account; and

(3) The rights and responsibilities of the student with respect to enrollment at the institution and receipt of financial aid. Such information includes the institution's refund policy, its standards of satisfactory progress, and other conditions that may alter the student's aid package.

(20 U.S.C. 1088f-1)

§ 168.16 [Reserved]

§ 168.17—*Attribution of (1) institutional refunds and (2) repayments of cash disbursements made directly to the student*

(a) (1) If a refund is due to a student under the institution's refund policy and the student received financial aid under any student financial aid program authorized under Title IV, a portion of that refund must be attributed to each program, except the College Work-Study Program, from which the student received funds.

(2) If the student received a Basic Grant, a portion of the refund must be restored to the institution's Basic Grant account or to the Commissioner. If the student received a Supplemental Grant, a portion of the refund must be restored to the institution's Supplemental Educational Opportunity Grant account. If the student received a National Direct Student Loan and/or a Guaranteed Student Loan, a portion of the refund must be used to reduce the principal on those loans.

(3) The amount to be restored to each account shall bear the same ratio to the total amount of the refund as the amount of funds provided to the student from each program up to the time of his withdrawal bears to the total amount of the student's educational costs for the payment period for which the refund applies, less any earnings from employment during that period. Expressed as a ratio, the amount of the refund to be attributed to each grant or loan aid source is as follows:

$$\frac{\text{Amount to be attributed to each program}}{\text{Total amount of institutional refund}} = \frac{\text{Amount provided by each program}}{\text{Student's cost of education for the period for which aid was awarded, minus amount of student earnings during the period}}$$

(b) The portion of the institutional refund to be restored or credited shall be computed as follows:

(1) (i) Determine the amount of the student's cost of education for the payment period for which the refund applies, and subtract any portion of that cost which was met by the student with earnings from the College Work-Study Pro-



gram or other employment occurring during the payment period for which the refund applies.

(2) Determine the amount of funds from each program authorized under Title IV, other than the College Work-Study Program, which were disbursed to the student or credited to the student's account to meet his or her costs of education for the payment period for which the refund applies.

(3) Divide each of the amounts in subparagraph (2) by the amount determined in subparagraph (1) to determine the percentage which each funding source constitutes of the aggregate amount applied to the student's educational costs.

(4) Multiply the percentages computed in subparagraph (3) by the amount of the institutional refund to determine the portion of the refund to be allocated to each aid program.

(c) The amount of the institutional refund which remains after the amounts computed in paragraph (b) have been subtracted and restored to the appropriate aid account may be attributed to the expected family contribution. However, before any remaining funds may be returned to the student the institution must first, in accordance with paragraph (d) of this section, apply those funds against any funds that were disbursed directly to the student for that period under the Basic Grant, Supplemental Grant, National Direct and Guaranteed Student Loan programs, which the institution determines, were not used for educational costs. The institution must then transfer any remainder to the lender if the student received a Guaranteed Student Loan and agreed to assign any refund to the lender to reduce the principal balance on his loan. (Appendix C contains an example demonstrating the method of computing the apportionment of an institutional refund outlined in this section.)

(d) *Attribution of repayments of cash disbursements made directly to the student.*

(1) If a student officially or unofficially withdraws from or is expelled by an institution prior to the first day of classes of a payment period, any cash disbursements made to that student for noninstitutional costs under any Title IV program (except the College Work-Study Program) for that period is an overpayment.

(2) If a student officially or unofficially withdraws from or is expelled by an institution on or after the first day of classes of a payment period, and the student received a cash disbursement for noninstitutional costs under any Title IV program (except the College Work-Study Program) for that period, the institution must determine whether a portion of that cash disbursement is an overpayment.

(3) In determining whether a student received an overpayment in the situation described in subparagraph (2) of this paragraph, the institution shall take into account the educational costs incurred by the student for noninstitutional charges for that payment period up to the date of withdrawal or expulsion. The institution shall then subtract that amount from the cash disbursements received by the student for that period. A remainder indicates that an overpayment was received. Noninstitutional costs may include but are not limited to room and board, books and supplies, transportation and miscellaneous expenses.

(4) The portion of the overpayment attributable to each program shall be computed using the following ratio:

Amount to be attributed to each program	Amount provided by each program for the period for which aid is awarded
Total amount of cash disbursement determined by the institution to be an overpayment	Student's cost of education for the period for which aid was awarded minus amount of student earnings during the period

(20 U.S.C. 1088f-1)

**§ 168.18 Additional factors for evaluating administrative capability and financial responsibility**

(a) The following conditions may impair an institution's ability to be financially responsible or to be capable of properly administering student financial aid programs authorized under Title IV:

(1) If the principal amount of defaulted loans made to students at an institution under the Guaranteed Student Loan Program or the National Direct Student Loan Program represents more than 20 percent of the principal of all such loans which has reached the repayment period,

(2) For an institution which has a common academic year for a majority of its students:

(i) If more than 33 percent of the students who are enrolled at the beginning of an academic year withdraw from enrollment at that institution during that academic year, or

(ii) If more than 50 percent of the students who are enrolled at the beginning of an academic year receive loans under the Guaranteed Student Loan Program for that year,

(3) For an institution which does not have a common academic year for a majority of its students,

(i) If more than 33 percent of the students enrolled at the beginning of any eight-month period withdraw during that period, or

(ii) If more than 50 percent of the students enrolled at the beginning of any eight-month period receive loans under the Guaranteed Student Loan Program for that year,

(4) For an institution utilizing accrual accounting in their last Fiscal Year,

(i) If the institution's ratio of current assets to current liabilities is less than 1:1,

(ii) If the institution has a deficit net worth. Deficit net worth is defined as a condition where the liabilities of the institution exceed its assets, or

(iii) If the institution has a history of operating losses.

(5) For an institution utilizing cash accounting in their last Fiscal Year,

(i) If their operating expenses exceed revenue,

(ii) If the institution has a deficit net worth as defined in § 168.18(4), or

(iii) If the institution has a history of operating losses.

(6) For an institution utilizing fund accounting, if the unrestricted current or operating fund reflects a deficit at the conclusion of its most recent Fiscal Year,

(7) For the purpose of making this determination the institution will make available to the Commissioner, upon a reasonable request, its latest financial statement prepared by a certified public account or the most reasonable equivalent thereof.

(b) If the Commissioner has reason to believe that the conditions set forth in paragraph (a) of this section exist at an institution or if the institution changes ownership, the Commissioner may require the institution to submit for its latest fiscal year a financial statement or an audit prepared by a State or local audit agency for a public institution, or certified by a certified public accountant or licensed public accountant for a non-public institution. The financial statement or audit must include, at least, a balance sheet and an operating statement (profit and loss statement covering both income and expenses), and it must be signed by a duly authorized officer of the institution attesting to its accuracy as of the date of the statement. The data of the statement must be within 12 months of the date of the application.

(c) If the Commissioner determines that any of the conditions described in paragraph (a) of this section impairs the capability of the institution to administer any financial aid program authorized under Title IV, the Commissioner may require the institution to take reasonable and appropriate measures to alleviate those conditions as a requirement for its continued participation in those programs. Before initiating such an action, the Commissioner will inform the institution of the findings and provide it a reasonable period to respond. That period will be at least thirty-five days. The institution's response may indicate that the conditions do not have an adverse affect on the administration of the programs, or the response may be to submit a plan of the action it will take to alleviate those conditions.

(20 U.S.C. 1088f-1)

#### SUBPART C—MISREPRESENTATION

##### § 168.31 Scope and purpose

This subpart establishes the standards and rules under which the Commissioner may initiate suspension or termination proceedings against an otherwise

eligible institution for any substantial misrepresentation made by that institution regarding the nature of its educational program, its financial charges, or the employability of its graduates.

(20 U.S.C. 1088f-1(c))

§ 168.32—*Special definitions*

"Misrepresentation" means any erroneous or misleading statement on otherwise eligible institution makes to a student enrolled at the institution, to any prospective student, to the family of an enrolled or prospective student, or to the Commissioner.

"Prospective student" means any individual who has contacted an otherwise eligible institution for the purpose of requesting information about enrolling at the institution or who has been contacted directly by the institution or indirectly through general advertising about enrolling at the school.

"Substantial misrepresentation" means any misrepresentation on which the person to whom it was made could reasonably be expected to rely, or has reasonably relied, to that person's detriment.

(20 USC 1088f-1(c))

§ 168.33 *Nature of educational program*

Misrepresentation by an institution of the nature of its educational program includes, but is not limited to, false or misleading statements concerning:

- (a) The nature and extent of the institution's accreditation;
- (b) Whether course credits earned at the institution may be transferred to any other institution;
- (c) Whether successful completion of a course of instruction qualifies a student for:
  - (1) Acceptance into a labor union or similar organization; or
  - (2) Receipt of a local, State, or Federal license or non-governmental certification which is required as a pre-condition for employment or to perform certain functions;
- (d) Whether its courses are recommended (i) by vocational counselors, high schools, or employment agencies; or (ii) for acceptance for governmental employment;
- (e) Its size, location, facilities, or equipment;
- (f) The availability, frequency, and appropriateness of its courses and programs to the employment objectives which it states its programs are designed to meet;
- (g) The nature, age, and availability of its training devices or equipment, and their appropriateness to the employment objectives which it states its programs and courses are designed to meet;
- (h) The number, availability, and qualifications, including the training and experience, of its faculty and other personnel;
- (i) The availability of part-time employment or other forms of financial assistance;
- (j) The nature and availability of any tutorial or specialized instruction, guidance and counseling, or other supplementary assistance it will provide its students either before, during, or after the completion of a course; or
- (k) The nature or extent of any prerequisites established for enrollment in any course.

(20 U.S.C. 1088f-1(c))

§ 168.34 *Nature of financial charges*

Misrepresentation by an institution of the nature of its financial charges includes, but is not limited to, false or misleading statements concerning:

- (a) Offers of scholarships to pay all or part of a course charge, unless a scholarship is actually applied to reduce a charge which is made known in advance to and applied to all students not receiving such a scholarship; or
- (b) Whether a particular charge is the usual and customary charge for a course.

(20 USC 1088f-1(c))

§ 168.35 *Employability of graduates*

Misrepresentations by an institution regarding the employability of its graduates includes, but is not limited to, false or misleading statements—

(a) That the institution is connected with any governmental organization, or is an employment agency or other agency providing governmentally authorized training leading directly to employment;

(b) That the institution maintains a placement service for graduates or will otherwise secure or assist its graduates to obtain employment, unless it provides the student with a clear and accurate description of the extent and nature of this service or assistance and unless it actually provides the service or assistance; or

(c) Concerning government job market statistics in relation to the potential placement of its graduates.  
(20 U.S.C. 1088f-1(c))

#### § 168.36 Endorsement and testimonials

Endorsement and testimonials which are not given voluntarily or which do not describe current practices and conditions of the institution will be viewed as misrepresentations by the Commissioner.  
(20 U.S.C. 1088f-1(c))

#### § 168.37 Procedures

(a) The designated OE official, as defined in subpart E, will, upon receipt of written allegations or complaints from students, prospective students, the family of students or prospective students, or governmental officials, review the allegations or complaints to determine their factual base and seriousness.

(b) If the misrepresentations are of a minor nature and can be readily corrected, the designated OE official will inform the institution and endeavor to obtain an informal, voluntary correction.

(c) If the designated OE official finds that the complaints or allegations relate to substantial misrepresentations as to the nature of the educational programs, the financial charges of the institution, or the employability of its graduates, the designated OE official will initiate action to suspend, limit, or terminate the institution's eligibility according to the procedure set forth in Subpart H, or will take other appropriate action.  
(20 U.S.C. 1088f-1(c))

## APPENDIX A

### Standards for Audit of Governmental Organizations, Programs, Activities, and Functions (GAO)

#### PART III

#### CHAPTER 3

#### INDEPENDENCE

(a) The third general standard for governmental auditing is:

In all matters relating to the audit work, the audit organization and the individual auditors shall maintain an independent attitude.

(b) This standard places upon the auditor and the audit organization the responsibility for maintaining sufficient independence so that their opinions, conclusions, judgments, and recommendations will be impartial. If the auditor is not sufficiently independent to produce unbiased opinions, conclusions, and judgments, he should state in a prominent place in the audit report his relationship with the organization or officials being audited.<sup>1</sup>

(c) The auditor should consider not only whether his or her own attitudes and beliefs permit him or her to be independent but also whether there is anything about his or her situation which would lead others to question his or her independence. Both situations deserve consideration since it is important not only that the auditor be, in fact, independent and impartial but also that other persons will consider him or her so.

<sup>1</sup> If the auditor is not fully independent because he or she is an employee of the audited entity, it will be adequate disclosure to so indicate. If the auditor is a practicing certified public accountant, his or her conduct should be governed by the AICPA "Statements on Auditing Procedure."

(d) There are three general classes of impairments that the auditor needs to consider; these are personal, external, and organizational impairments. If one or more of these are of such significance as to affect the auditor's ability to perform his or her work and report its results impartially, he or she should decline to perform the audit or indicate in the report that he or she was not fully independent.

#### PERSONAL IMPAIRMENTS

There are some circumstances in which an auditor cannot be impartial because of his or her views or his or her personal situation. These circumstances might include:

1. Relationships of an official, professional, and/or personal nature that might cause the auditor to limit the extent or character of the inquiry, to limit disclosure, or to weaken his or her findings in any way.
2. Preconceived ideas about the objectives or quality of a particular operation or personal likes or dislikes of individuals, groups, or objectives of a particular program.
3. Previous involvement in a decisionmaking or management capacity in the operations of the governmental entity or program being audited.
4. Biases and prejudices, including those induced by political or social convictions, which result from employment in or loyalty to a particular group, entity, or level of government.
5. Actual or potential restrictive influence when the auditor performs pre-audit work and subsequently performs a post audit.
6. Financial interest, direct or indirect, in an organization or facility which is benefiting from the audited programs.

#### EXTERNAL IMPAIRMENTS

External factors can restrict the audit or impinge on the auditor's ability to form independent and objective opinions and conclusions. For example, under the following conditions either the audit itself could be adversely affected or the auditor would not have complete freedom to make an independent judgment.<sup>2</sup>

1. Interference or other influence that improperly or imprudently eliminates, restricts, or modifies the scope or character of the audit.
2. Interference with the selection or application of audit procedures or the selection of activities to be examined.
3. Denial of access to such sources of information as books, records, and supporting documents or denial of opportunity to obtain explanations by officials and employees of the governmental organization, program, or activity under audit.
4. Interference in the assignment of personnel to the audit task.
5. Retaliatory restrictions placed on funds or other resources dedicated to the audit operation.
6. Activity to overrule or significantly influence the auditor's judgment as to the appropriate content of the audit report.
7. Influences that place the auditor's continued employment in jeopardy for reasons other than competency or the need for audit services.
8. Unreasonable restriction on the time allowed to competently complete an audit assignment.

#### ORGANIZATIONAL IMPAIRMENTS

(a) The auditor's independence can be affected by his or her place within the organizational structure of governments. Auditors employed by Federal, State, or local government units may be subject to policy direction from superiors who are involved either directly or indirectly in the government management process. To achieve maximum independence such auditors and the audit organization itself not only should report to the highest practicable echelon within their government but should be organizationally located outside the line-management function of the entity under audit.

(b) These auditors should also be sufficiently removed from political pressures to ensure that they can conduct their auditing objectively and can report

<sup>2</sup> Some of these situations may constitute justifiable limitations on the scope of the work. In such cases the limitation should be identified in the auditor's report.

their conclusions completely without fear of censure. Whenever feasible they should be under a system which will place decisions on compensation, training, job tenure, and advancement on a merit basis.

(c) When independent public accountants or other independent professionals are engaged to perform work that includes inquiries into compliance with applicable laws and regulations, efficiency and economy of operations, or achievement of program results, they should be engaged by someone other than the officials responsible for the direction of the effort being audited. This practice removes the pressures that may result if the auditor must criticize the performance of those by whom he or she was engaged. To remove this obstacle to independence, governments should arrange to have such auditors engaged by officials not directly involved in operations to be audited.

### APPENDIX 3

#### Standards for Audit of Governmental Organizations, Programs, Activities and Functions (GAO)

##### QUALIFICATIONS OF INDEPENDENT AUDITORS ENGAGED BY GOVERNMENTAL ORGANIZATIONS

(a) When outside auditors are engaged for assignments requiring the expression of an opinion on financial reports of governmental organizations, only fully qualified public accountants should be employed. The type of qualifications, as stated by the Comptroller General, deemed necessary for financial audits of governmental organizations and programs is quoted below:

"Such audits shall be conducted \* \* \* by independent certified public accountants or by independent licensed public accountants, licensed on or before December 31, 1970, who are certified or licensed by a regulatory authority of a State or other political subdivision of the United States: Except that independent public accountants licensed to practice by such regulatory authority after December 31, 1970, and persons who although not so certified or licensed, meet, in the opinion of the Secretary, standards of education and experience representative of the highest prescribed by the licensing authorities of the several States which provide for the continuing licensing of public accountants and which are prescribed by the Secretary in appropriate regulations may perform such audits until December 31, 1975; provided, that if the Secretary deems it necessary in the public interest, he may prescribe by regulation higher standards than those required for the practice of public accountancy by the regulatory authorities of the States."<sup>1</sup>

(b) The standards for examination and evaluation require consideration of applicable laws and regulations in the auditor's examination. The standards for reporting require a statement in the auditor's report regarding any significant instances of noncompliance disclosed by his or her examination and evaluation work. What is to be included in this statement requires judgment. Significant instances of noncompliance, even those not resulting in legal liability to the audited entity, should be included. Minor procedural noncompliance need not be disclosed.

(c) Although the reporting standard is generally on an exception basis—that only noncompliance need be reported—it should be recognized that governmental entities often want positive statements regarding whether or not the auditor's tests disclosed instances of noncompliance. This is particularly true in grant programs where authorizing agencies frequently want assurance in the auditor's report that this matter has been considered. For such audits, auditors should obtain an understanding with the authorizing agency as to the extent to which such positive comments on compliance are desired. When coordinated audits are involved, the audit program should specify the extent of comments that the auditor is to make regarding compliance.

(d) When noncompliance is reported, the auditor should place the findings in proper perspective. The extent of instances of noncompliance should be related to the number of cases examined to provide the reader with a basis for judging the prevalence of noncompliance.

<sup>1</sup> Letter (B-148144, Sept. 15, 1970) from the Comptroller General to the heads of Federal departments and agencies. The reference to "Secretary" means the head of the department of agency.

(The pamphlet "Standards for Audit of Governmental Organizations, Programs, Activities and Functions" is for sale by the Superintendent of Documents, U. S. Government Printing Office, Washington, D.C. 20402. Stock number 2000-00110. Price: 85 cents.)

## APPENDIX C

The following example demonstrates the method of computing the apportionment of an institutional refund outlined in § 168.17(b). Assume the refund is \$500.  
Example:

Cost of education for the period.....	\$2, 200
Minus portion of cost met with student's payment period earnings.....	- 200
	2, 000
Institutional refund.....	500

Aid program	Amount of financial aid for the period for which the refund applies	Cost of education minus portion met with student's earnings	Percentage	Total refund	Amount to be restored to aid program account
Basic grant.....	250	\$2, 000	12.5	\$500	\$62.50
Supplemental grant.....	750	2, 000	37.5	500	107.50
Student loan (NDSL or GSL).....	550	2, 000	27.5	500	137.50
					387.50
Total refund.....					500.00
Amount restored to aid programs.....					-387.50
Amount to be applied against (1) repayment of basic grant or supplemental grant funds disbursed directly to the student and (2) reduction of the principal amount of National Direct or Guaranteed Student Loan disbursed directly to the student, for that period, and any remainder returned directly to the student as indicated in section 160.17(c).....					112.50

Senator PERCY. We have another vote on. It will take me about 5 minutes, round trip. Rather than hold you up any longer, I am going to ask Mr. Block to go ahead and continue the line of questioning, and I will be back.

[At this point Senator Percy withdrew from the hearing room.]

Mr. BLOCK. Just a few more questions with respect to the student loan matter. Do you feel that the accreditation process should be improved to assure that only bona fide educational institutions are approved for Federal assistance?

Mr. MORRIS. I would like to answer that for the record, if I may. Again, we are not experts in these areas, and we are not sure what the regulations require.

[Additional material furnished follows:]

The accreditation process should be improved. Moreover, the Office of Education should work collaboratively with accrediting agencies in order to help them upgrade the effectiveness of their operations. At the present time, the Office has several efforts underway which are designed to assist accrediting agencies strengthen their operations. However, regarding assuring the bona fide character of educational institutions, I must note that the primary process for providing such assurance is that of State legal authorization for postsecondary institutions to operate—commonly referred to as institutional licensure, approval, or chartering.

It has been our experience that accreditation, with its purpose of determining educational quality, can be most effective when it is built on the foundation of competent State institutional authorization processes. Therefore, we believe that a high priority effort, in addition to that of assisting accrediting agencies to strengthen their operations, should be undertaken by the Office of Education to upgrade the capabilities of State legal authorizing agencies for postsecondary

educational institutions. We are now considering several potential strategies to achieve this goal.

Mr. BLOCK. Would it help to have periodic surprise audits of the over 8,000 institutions that are participating in the various student financial aid programs?

Mr. MORRIS. I think so.

As I mentioned, we are going to require regular periodic independent audits of each institution, as well as the special field reviews that OE is contemplating. I believe a periodic surprise audit would be an additional useful tool. We are now undertaking one research effort on beauty schools, of which there are 800 or so, to see if there are ways we can examine clusters of schools, or industry-type groups—correspondence schools, trade schools, and so on—periodically, to expose problem schools, much like we are doing in Project Integrity.

Mr. BLOCK. Do you think that, considering the large number of institutions involved and the reliance that HEW places on the accreditation organizations, that they ought to be required to provide more specific information, for instance, background information on the principal parties and the administrators. Would such requirements help do away with the problem that came up in the *West Coast Schools* case, where you had a shady operator at the head of the organization?

Mr. MORRIS. If you will permit me again, I would like to answer that for the record. I think OE should properly express the departmental view of these matters. We will join with them on that.

[The information to be furnished follows:]

In the case of the West Coast Trades Schools, there was not a failure on the part of accreditation organizations. This is a common misconception. Indeed, in this case, of the six schools involved, only one was accredited, and the accrediting agency refused accreditation to the other five. We believe that the accrediting agency was in the process of withdrawing status from the one accredited school. However, instances such as the West Coast Trades Schools case could be greatly reduced if the State legal authorization agencies were assisted by the U.S. Office of Education to become more effective. It is the State authorization agencies which offer the most legally secure and effective capability to address and investigate matters such as the backgrounds of principal parties and administrators of proprietary schools. One strategy we are considering is the creation of an effective information sharing system among the States, the Office of Education, and the accrediting agencies.

Mr. BLOCK. Going back to the \$7 billion estimate that you gave in your annual report of fraud, waste, and abuse in HEW, is it possible, as you expand your review of HEW programs, and as investigatory and audit techniques improve, that the amount that you have estimated to be lost might actually increase in your next annual report?

Mr. MORRIS. Again, we hesitate to speculate on the future. It is apparent that we did not cover every program. The inventory included the best available data available from congressional reports, GAO reports, and the studies of the Department.

There are some obvious gaps. Those we hope to close.

At the same time, the Department has started a very vigorous cost reduction effort. We think that is the name of the game—getting that kind of motivated, disciplined effort started. It should be producing results which will offset some of the findings of the future, so to speak.



We would like to let the facts determine what we report to you next year, and be just as helpful as we can be.

Mr. BLOCK. In your testimony you mentioned that in 1977 113 criminal convictions were obtained as a result of HEW investigative efforts. How does that figure compare to previous years and how does it compare to your figures for 1978?

Mr. MORRIS. It was the first time those data had ever been collected and put on paper. So there is no data base, no history from the past to look at.

We are certain that it is much greater in the sense that our Office of Investigations, which had about half those cases, a little less than half, had not had the resources in past years to develop and pursue this kind of effort that it had in the past year. And we will have much more in the future.

All I can say is we will have a data base in the future to compare with this report.

Mr. BLOCK. Do you have any figures for calendar year 1978?

Mr. MORRIS. We have the first several months of the fiscal year. We are running 31 convictions at the 6-month point, which is a rate somewhat greater for our Office of Investigations than in the last calendar year, which totaled 51 for 12 months. Now we have 31 in 6 months. Whether that rate will hold up, we don't know. We suspect it might.

Mr. BLOCK. What percentage of the resources of the Office of Investigations have been put into the computer matching projects, Project Match, and Project Integrity? What has been the offsetting disadvantage in terms of cases that have had to be put on the back burner while resources have gone into those programs?

Mr. MORRIS. This has varied almost from month to month during this past year. Currently the Office of Investigations is assigning about 17 out of its 77 field personnel to Project Integrity. Very little of the staff, except two people here at headquarters, are spending time on Project Match. What we hope for in the future—when we double our staff, as we expect to starting in October—is that we can assign enough people to our regular cases to stay abreast of that workload on an annual basis. This will require 120 people. Then we would have another group of 40-plus people who can be drawn on for other efforts, including transfer of work from HCRA and special initiatives.

That is our objective. It is true that we have had to delay many cases we did not wish to delay in order to give priority to Project Integrity work in the past year. That was a conscious decision.

But we don't want to have to continue that in the future.

Mr. BLOCK. What is the case backlog at the present time?

Mr. MORRIS. There are 957 total cases in the Office of Investigations—it is the last page of our statement—of which 407 are in the active investigative phase, plus 550 cases we call "pending inactive"—that is, ready for prosecution, or work is being done by people other than our own staff.

Mr. BLOCK. In using the computer lists in these programs, do you see any threat to people's right to privacy by the massive use of computer matching? What is done to protect the records of those

whom the computer selects as possible suspects for investigation, but who turn out to have done nothing wrong?

**Mr. MORRIS.** This is a matter of the utmost concern and importance to us, as well as to the Office of Management and Budget, and the executive branch generally. I am going to ask Mr. Ruff to comment in detail. But as a principle, we do not undertake any of these efforts without a fully developed operating plan that spells out in detail what we are going to do, and how we are going to protect the privacy rights of the individual concerned.

**Mr. RUFF.** To address the specific question you raise, Mr. Block, wherever anyone is identified as legitimately in receipt of the benefits, for example, AFDC benefits from Project Match, he is removed from the matching process; the worksheet which represents the information about him or her is simply taken out of the process. All these documents, all the tapes, the entire matching procedure itself is under the control of a senior auditing agency staff member here in Washington. Computer runs are handled under his direction. The documents that are given to other agencies for additional information or distributed to States all funnel through his office, where we have one point of control.

In addition, we have met individually with each one of the States who are participating in Project Match, as well as each one of the Federal agencies who are participating, using the good offices of the Civil Service Commission, to stress to them the importance of minimizing the number of persons who have access to this information when they provide us with validated salary data, and so forth.

Beyond the specifics of our Project Match safeguards, we have engaged in the last several months in some extensive discussions with the Office of Management and Budget, which have resulted in what I expect to be, sometime in the next several days, the issuance of some very detailed guidelines for the guidance of all Federal agencies, executive branch agencies, on the conducting of matching programs. They will lay out in detail the basis for the matching program, the justification for it, the steps that are going to be taken to operate it, and the safeguards that are going to be used to protect the privacy of the individuals.

We have tried to attack this in the individual matches we have run and the operating plans that we have developed to safeguard privacy. Further, almost wholly as a result of our becoming involved in these kinds of things in HEW, and our discussions with OMB, there has been developed in the executive branch a set of guidelines which we think will meet all the privacy concerns.

**Mr. BLOCK.** In that regard, are there different kinds of problems that come up when you deal with Project Integrity? As I understand it, that program would tend to involve more personal investigation, followup investigation that would have to be done to determine what practices have been appropriate and what have not. Are there privacy considerations?

**Mr. RUFF.** There are privacy considerations any time the Federal Government inquires into the activities of a citizen. But they are substantially less in Project Integrity than Project Match. There is

no matching in Project Integrity. We take basically a claims payment tape and analyze it through use of the computer. These are people or institutions in contractual relationships with the Government, which would be true in any business. We treat our inquiry as highly confidential and do not make any public disclosures in terms of names we are looking into, or what the results of individual cases may be, unless there is public disclosure attendant to an indictment and a prosecution.

The essential right of privacy that an AFDC recipient would have about disclosure of his status or any information about it is not quite the same as the right of a doctor or pharmacist who enters into contractual agreement with the Government and whose claims we are analyzing through use of the computer. I think that is a distinction that has to be made.

Mr. BLOCK. Mr. Morris, on page 17 of your testimony, you stated that once the proceeds of an HEW grant are in the possession of the grantee, it is not a Federal offense to steal. What does this mean, and does it translate into the fact that once the person gets ahold of the grant money, that they are pretty much at liberty to do what they want with the funds?

Mr. MORRIS. Mr. Ruff will discuss that.

Mr. RUFF. As I think I indicated in response to Senator Nunn's question, our concern here is that there seems to be a substantial amount of uncertainty in the courts whether the statute, 18 U.S.C. 641, which makes it a crime to steal Government funds, applies in the situation in which grant funds go out to a recipient and are placed in the recipient's bank account, or wherever, and are later misused in some fashion.

The case that gives us the most pause at the moment is the case of the *United States v. Collins*, described earlier, which has been raised by a number of defendants in similar situations around the country, most recently of interest to us in the fifth circuit by some individuals who were convicted of stealing student aid funds from institutions in that State.

It is our view that there should not be this uncertainty in the law—that it would be a relatively easy matter, and one that I think is wholly appropriate under the circumstances, for Congress to reach out and make clear that where funds go out to a recipient for a defined Federal purpose, and someone simply steals them, or criminally converts them, that that ought to be a Federal offense.

Mr. BLOCK. In February of this year, GAO issued a report after a study of a \$12.8 million contract, which the National Cancer Institute had with a private research firm in Nebraska. In that report, GAO condemned the way that the NCI officials monitored the contract, calling it lax and ineffective, and determined that this led to Federal funds being used for projects that had not been approved, and for personnel supplies and animals not being used for contract purposes. Is that the kind of practice that is not now reached by the Federal criminal statutes that you would seek to have it reach?

Mr. RUFF. No, I think that is really a kind of situation that is more appropriately reached by civil and administrative processes. This is

not a matter of someone reaching out and stealing, particularly for personal benefit, Federal funds.

[At this point, Senator Percy entered the hearing room.]

Mr. RUFF. It really is a matter of whether or not the funds that were used, albeit for perfectly laudable institutional purposes, were used in compliance with the specific requirements of the grant, or the contract as it was developed.

What I have in mind in the other area, really, is the situation in which money goes out to a community organization of some kind, for a specific purpose, and someone with access to the bank account simply says, "I am going to take \$1,000 of that money and spend it for my own personal purposes." That is really the truly egregious criminal offense. The kind of situation you have described is one we can reach simply by better contract controls at HEW, and by assuring administrative and civil followup where necessary to recover funds that are improperly spent.

Mr. BLOCK. Thank you.

Senator PERCY. I would like to turn to the National Institute of Drug Abuse now, and the allegations against it for mismanaging. I presume that both of you saw the column that appeared—the first one in January of this year—by the syndicated columnist, Jack Anderson, when he began a series of columns disclosing apparent conflict of interest and mismanagement in the National Institute of Drug Abuse. He identified three basic types of managerial abuses. First, he cited several cases whereby Federal contracts were awarded to long-time friends or consulting firms employing NIDA officials' wives. Second, the columnist questioned the value of some of the research projects which NIDA had funded since its inception in 1973. Also, Mr. Anderson questioned numerous business trips made by high-ranking officials both in and outside the country.

Secretary Califano read the articles with interest and ordered your office to conduct an investigation of charges. You reported on May 26, stating in large measure these allegations were factually correct.

If I remember your report correctly, though, it did indicate that the trips were—I think the accrued charge was approximately \$27,000—that they were valid trips for valid purposes, if I recall correctly.

Mr. RUFF. That is correct.

Senator PERCY. But you did seriously question other aspects of their operations, and verified as factually correct many of the statements made by Jack Anderson. You included in the report a series of recommendations on how to correct the abuses which had been identified.

Appearance of conflict of interest and cronyism in the awarding of Government contracts serves to undermine the credibility of Government at all levels. It inhibits the ability of Government to operate.

What punitive measures do you have at your disposal to use as a means of deterring employees from providing favors to friends and relatives, and what recommendations did you make in this regard?

Mr. RUFF. Senator, the truly egregious situation in which there is a direct quid pro quo for some favor performed by a Federal employee is very clearly a criminal matter. Where we find that, we move

rapidly on it with the Justice Department and pursue the conflict of interest charges against the individual, criminal conflict of interest charges, or where the facts would support it, bribery. The broader problem is the one simply of an atmosphere in which free flow of exchange of favors between HEW employees or employees of any other agency and grantees and contractors occurs, an atmosphere in which the integrity of the grant-making or the contracting process is called into question. There, I think, it is fair to say we have moved on a couple of fronts:

One, the Secretary has set up in the Assistant Secretary of Personnel's office, a special new unit to deal with personnel integrity. We hope to work with them fairly closely over the next several months, to improve the basic educational program, to reach out to HEW employees and make it clear to them just exactly what is covered by the code of conduct at HEW—make it clear to them that a friendly drink with the contractor or grantee when viewed in retrospect may be something more than that.

Specifically, with respect to NIDA, we made some recommendations with respect to the grantmaking process there, and the Secretary asked the Assistant Secretary for Management and Budget, as well as the Assistant Secretary for Personnel and General Counsel to look into our recommendation. They reported back preliminarily to the Secretary on a number of areas in which they intend to move.

For example, the contracting and grant-making process is going to be centralized and taken out of the immediate responsibility of the operating division, which we felt had exercised too great control over the decision as to who got the grant contract money.

There is going to be an accelerated training program for these grant and contract personnel, to make them aware of the kinds of problems we have developed, and how to deal with them.

To deal with one of the very special problems that we found there, NIDA's parent organization, the Drug Abuse and Mental Health Administration, is developing a policy now to require the disclosure of what we would call special relationships between applicants for grants and contracts and individuals who hold positions with the agency, that might, even though they are not formally conflicts of interest within the meaning of the statute, nonetheless either influence the making of the grant or indicate to the public at least the appearance of some impropriety.

We think this is really a new idea, one that we would like to explore, and we would hope would bring to the attention of the people who are in this business at NIDA and similar agencies the problem of being extra careful in dealing with those cases where friendship or relationships might improperly influence the decision-making process.

Senator PERCY. I think that is good, sound advice and ought to be promulgated.

Can you tell us if there is any ongoing investigation of any individuals who were cited for conflict of interest violations? Is your office planning any further investigations into the alleged improprieties of NIDA?

Mr. RUFF. There are, in a couple of instances, ongoing investigations, principally by the Assistant Secretary for Personnel, into allegations of individual misconduct. At the moment we don't believe these rise to the level of criminal violations, but may indeed be code of conduct and conflict of interest violations.

Our office, in particular, has one major matter under continuing investigation, which we described in very general terms in our report. I hesitate to be any more specific at this point, except to say that it does involve a major hospital contract on which there is some possibility of this investigation leading to criminal violations. We are pursuing that. We expect to have some results by the early fall.

Senator PERCY. What sanctions do you have available?

Mr. RUFF. Where there are code of conduct or administrative violations, the sanctions we would hope that would be imposed swiftly and efficiently would be disciplinary, ranging all the way from the mildest form of admonition to dismissal, where that seems warranted.

I think the key for us, though, is the creation of a new emphasis on the importance of integrity so that these problems don't arise in the future.

Senator PERCY. In regard to the three major areas of responsibility that your office has, I am sure you find some problems that call for both investigation and a long range solution. In the case of travel—a tremendous amount of travel in a department that obviously needs close supervision and management—if the head of the department is almost always away, how is that person to keep an eye on the shop? There may be a perfectly legitimate reason for giving a speech at this convention and that convention, but after all, that is not the main function and purpose Congress had in mind in setting up that office. It is not a good will office to share our knowledge of how we are controlling the drug problem.

We have a horrendous drug problem in this country. Finding solutions to that problem is NIDA's main mission. Is it within the jurisdiction of your office, then, to see that measures are taken and reports are made to the Secretary, so that we tighten up and restrict travel under such conditions?

[At this point Senator Nunn entered the hearing room.]

Mr. RUFF. In direct response to our report, the Assistant Secretary of Management and Budget has imposed new restrictions on the approval of foreign travel. We expect that a full review will have been completed in the near future of the manner in which that approval process operated at NIDA, the need for it, and with just exactly the point you have in mind, the question of how you manage a program like that, and still perform the necessary reaching out to both foreign governments and State and local governments who need our expertise.

That is something that the Assistant Secretary of Management and Budget is working on right now.

Mr. MORRIS. I might add, Secretary Califano is very sensitive to this point you just made. He personally directed that this be undertaken.

Senator PERCY. How do we determine that the abuses that have been revealed in NIDA—the administration of those programs and

the administration of that department—are not occurring in other departments? Is this an isolated case? Is it the worst case, but with the same kinds of practices, to a lesser degree, going on in other parts of HEW?

Mr. MORRIS. That is the reason Mr. Ruff made reference to this new unit in the Assistant Secretary for Personnel Office, known as Personnel Integrity, which is going to conduct departmentwide training on code of conduct and behavior practices.

We think that each should be given attention and in fact so said in our annual report.

Senator PERCY. I don't want to compete with Senator Proxmire on the Fleece of the Month Award, but there are some NIDA studies that have been questioned by others, where hundreds of thousands of dollars have been expended for the study of sociocultural aspects of marihuana use among primitive tribes. Do you believe the criteria for selecting which projects to fund needs to be changed? It may help ward off the dubious honor of being selected for the award of the month by Senator Proxmire.

Mr. RUFF. Senator, I think I certainly cannot even begin to second-guess or even first-guess the justification for grants in these specialized areas. We, therefore, very carefully did not attempt to analyze the priority of these grants, other than to ensure that they were made through the appropriate processes.

I will bow to Mr. Morris, if he has some more substantive thoughts on that subject. But we are, by statute and by inclination, at least in this area, as far as I am concerned, barred from the involvement in program operations. I wouldn't know how to begin to judge how best to spend the Federal dollars in the area of drug abuse prevention of this type. I trust you understand my abdication of responsibility in that area. It is an area that is simply beyond my expertise.

Mr. MORRIS. The Secretary does have an Assistant Secretary for Program Evaluation. We think his office might be the appropriate oversight mechanism.

Senator PERCY. It has been alleged that NIDA employees who complained about the travel habits of top level NIDA officials and the contract awards were downgraded for speaking out. Is this true? If so, have these employees been reinstated to their former positions and former pay? I wonder if you could take a look at the civil service reform bill that the committee has reported out to the Floor—which I think will carry on the floor of the Senate, and we hope in the House—providing certain protection for whistle blowers, and say whether or not the standards the Senate is about to adopt had been applied in the case of HEW? Could you tell us the status of those people who were whistle blowers and were downgraded?

Mr. RUFF. We specifically looked into those cases and interviewed each one of those employees who had been allegedly adversely affected about their claims. Each one denied that there was any relationship between their downgrading and their complaints. They did have other complaints about the procedures which resulted in their downgrading. They are pursuing those internally. But the one thing we were very careful to look into was the specific maltreatment of whistle blowers. We have an ongoing concern about this issue.

Our view is that any HEW employee ought to have the free right of access to our office to make any complaint about misconduct in the operation of HEW's agencies, and that that employee ought to be assured of privacy and confidentiality—that he ought to know he can come to us without any fear of retribution by us, certainly, or by his supervisor.

We also feel, I think, that when it comes to policy judgment, that is, whether or not a particular program ought to go forward, or whether a policy judgment was rightly or wrongly made, that that is really a separate whistle blowing problem, and one that ought to be dealt with not through the Inspector General's office, but through some other arm of the Department. We certainly support any legislative action to protect those who feel so strongly about policy judgments that they want to make their views known.

Senator PERCY. As I recall, you do support the Magleton legislation, establishing uniform standards for inspector generals and feel that a biannual report is adequate, rather than the quarterly, which you are now required to do.

Mr. MORRIS. That is correct, sir.

Senator PERCY. You have no other suggestions with respect to that legislation?

Mr. MORRIS. We thought we could live with that bill just as well as we have with our present bill.

Senator PERCY. I want to thank you very much indeed. Your testimony has been extraordinarily helpful to us. We appreciate it.

Senator NUNN. I join Senator Percy in expressing my thanks to both of you for being here today and for the work you have done. It is a big job and certainly anybody can second-guess some of the priorities you have chosen. But I feel you overall have moved generally in the right directions. I assure you our subcommittee will continue to cooperate with the number of investigations that we have ongoing and the number we will have in the future. We have an awful lot of individual matters that will come to our attention that we will continue to forward to you.

I might also say, Senator Harry Byrd asked me to express his gratitude. He is not on this subcommittee, but he is very concerned about this area. He asked me to express his gratitude to you, Mr. Morris, and Mr. Ruff, for the work you are doing in the full backing of this concept. You have got a lot of support here.

If you run into problems, I hope you would let us know because we would like to deal with them. As the author of the original concept, I certainly would like to be kept informed of both your problems and your opportunities.

Mr. MORRIS. We are very grateful for that, Senator. We will keep it in mind.

Senator NUNN. Thank you.

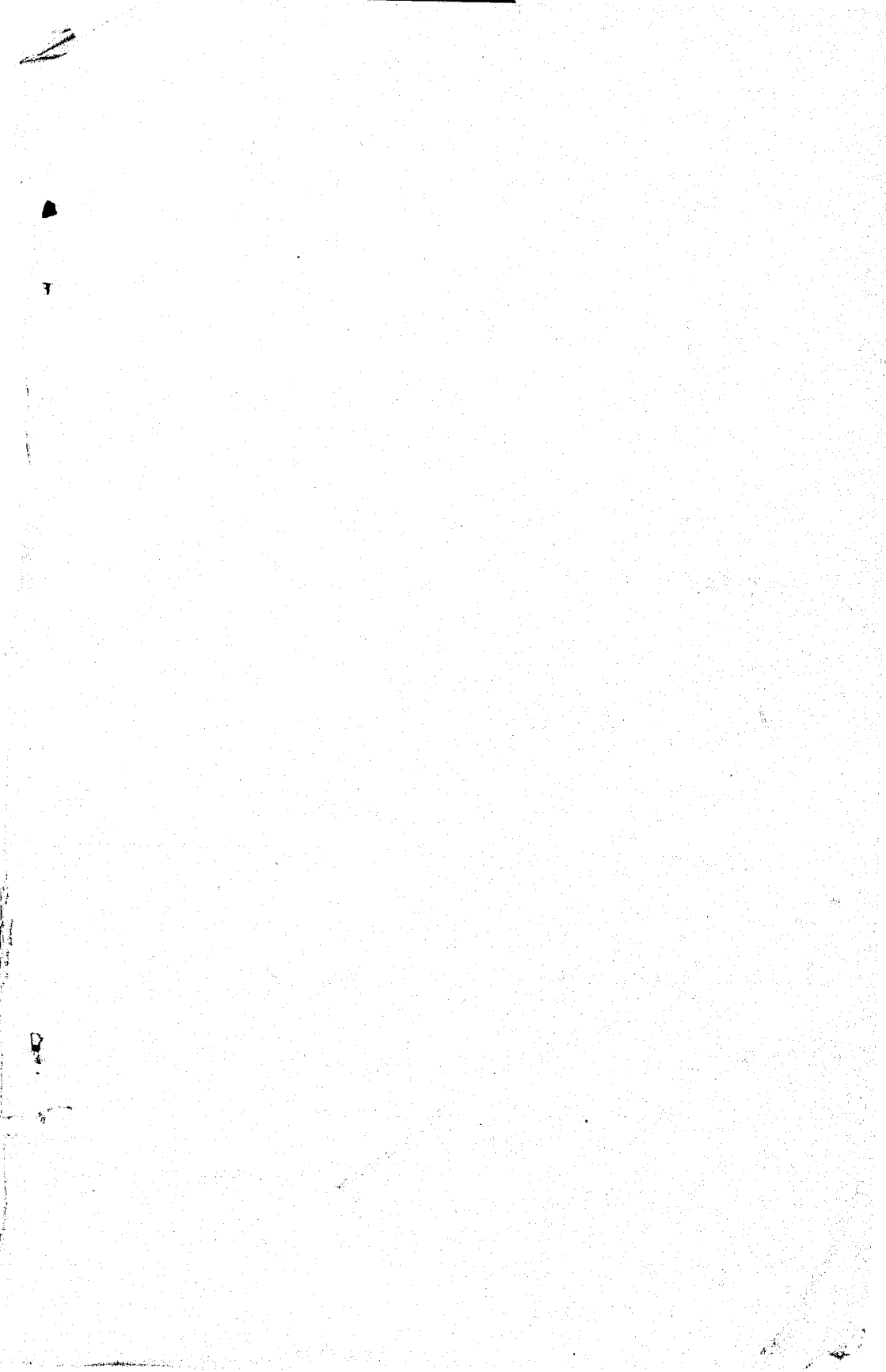
Thank you, Mr. Ruff.

Mr. RUFF. Thank you, Senator.

[Whereupon, at 11:55 a.m., the subcommittee recessed, to reconvene subject to the call of the Chair.]

[Members present at time of recess: Senators Nunn and Percy.]







**END**