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INFORMATION TECHNOLOGY

Questions Linger Over Rise and Fall of Online Program

Waiver of rules led to surge in students and finding of fraud

BY DAN CARNEVALE

Kevin Freels was enrolled at the Masters Institute when it shut down. "All that time that I had spent was wasted."

KENNETH HAYDEN, BLACK STAR, FOR THE CHRONICLE

SAN JOSE, CALIF.

KEVIN FREELS could have been a poster child for a new federal program designed to make it easier for student aid to reach people taking distance-education courses. A mortgage officer who lives in Evansville, Ind., he hoped to earn a bachelor's degree in information-technology management so he could change careers, but he couldn't find a traditional program to suit his schedule. So in December 2000, he enrolled in an online program at the Masters Institute, paying tuition with Pell Grants and applying for federal loans. But several months later, the college shut down.

"I went to log in one night, and they just weren't there," says Mr. Freels. "All that time that I had spent was wasted."

The Masters Institute here was part of a group of institutions hand-picked by the U.S. Department of Education to show that the government's existing financial-aid regulations could be safely waived for distance-education programs. The experiment, known as the Distance Education Demonstration Program, has been popular with proponents of distance education, particularly in Congress. But in the case of the Masters Institute, something went awry.

The 10-year-old regulations that were waived for the Masters Institute were designed to prevent fraud. But soon after Masters entered the demonstration project—permitting the college's distance-education offerings to grow rapidly—the Education Department determined that Masters's financial-aid program was riddled with fraud, according to information obtained by *The Chronicle* under the Freedom of Information Act. And some people familiar with the college have concluded that it was the Masters Institute's unregulated foray into distance education that caused it to go belly up.

Now, eager to promote the growth of distance education, Congress is considering loosening the same financial-aid rules for many colleges. Rep. Johnny Isakson, a Georgia Republican, says a bill that he proposed offers enough safeguards to prevent a Masters-like fiasco from recurring. But some observers worry that the lessons from the Masters Institute haven't been publicized enough for Congress to make an informed decision on the Isakson bill.

The Masters Institute opened as a California-regulated vocational college in 1973. Classrooms and offices were located in rented commercial space near the San Jose airport. Masters was a for-profit institution owned and operated by Les Nicholaeff. He still has an address in San Jose, but he did not return repeated telephone calls from *The Chronicle*. Other administrators who worked at the college could not be persuaded to speak on the record.

More than 1,200 students were taking courses online and 900 more were studying on site when Masters folded, in March 2001. Mr. Freels says he was lucky that his loan request had yet to be approved. (Even if he had received the money, the Education Department automatically forgives federal loans for students whose colleges close.) But some fellow students were a semester away from graduating and had spent more than $20,000 each for degrees they will never receive.

"I've heard stories from other people that had to pay lots of money," Mr. Freels says. "I was one of the lucky ones."

CHANGING THE RULES

Mr. Isakson's bill, HR 1992, passed the House of Representatives in October and is awaiting debate in the Senate.

Like the demonstration program, the legislation would allow some distance-education institutions to bypass two aid regulations. One is the 50-percent rule, which prohibits an institution from receiving federal student aid if more than 50 percent of its

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What the Education Department Found at Masters

THE U.S. DEPARTMENT OF EDUCATION released a review in 2000 that found 18 violations of financial-aid rules by the distance-education program at the Masters Institute, which never replied to the charges. Here is a sample of the findings:

- **Failure to report fraud:** During a partial audit, managers at Masters became aware of fraud involving at least five student records, but the Department of Education was never notified, as required.
- **Failure to determine that students were no longer enrolled:** Masters did not end the enrollments of students who had been absent for 21 consecutive days.
- **Failure to return federal aid for students who never attended:** Masters failed to return money for students who never logged in to the online courses.
- **Ineligible students:** Federal aid was disbursed to students despite incomplete or invalid paperwork.
- **Improper loans:** Loan certifications were inaccurate on numerous occasions.
- **Failure to provide matching funds:** In violation of federal rules, Masters did not provide matching funds for the Supplemental Educational Opportunity Grant and Federal Work-Study programs.
- **Pell Grants calculated incorrectly:** Full-time financial aid was awarded to part-time students.

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courses are offered at a distance or if more than 50 percent of its students take courses at a distance. Had it not been waived as part of the demonstration program, the 50-percent rule would have capped the number of distance-education students the Masters Institute could have enrolled.

The second regulation, known as the 12-hour rule, requires students to take at least 12 hours of course work a week to receive federal financial aid.

Under Mr Isakson's bill, the 50-percent rule would be waived for institutions with loan-default rates of less than 10 percent for the three preceding years. The 12-hour rule would be waived for all colleges

But the bill would waive the 50-percent rule only for colleges that already offer federal financial aid—traditional colleges with budding distance-learning programs or online institutions that are part of the demonstration project Online-only institutions that were not invited to join the demonstration, such as Jones International University, would continue to be prohibited from receiving federal student aid

The bill's proponents argue that current regulations are overbearing and will starve the growth of distance education by limiting students' eligibility for financial aid. Critics of the bill say the regulations are necessary to prevent the fraud and abuse that ran rampant before the safeguards were created in 1992

A SMALL, GROWING INSTITUTION

In the early 1990s, before the college ventured very far into distance education, the Masters Institute was running a relatively successful classroom-based program that had attracted about 900 students. Although some critics said the curriculum was substandard, and some dissatisfied students filed lawsuits that were later dismissed, Masters continued to expand

"Masters would not have been an issue if HR 1992 passed, because their default rate would have far surpassed the limit."

After the Distance Education Demonstration Program was proposed, in 1998, Masters administrators eyed it as a way to expand in online education Because most Masters students depended on financial aid, participation in the demonstration was essential for the growth of the college's distance-education program.

Officials at the Education Department who seek candidates for such experiments tend to look for colleges with a range of educational styles and locations. According to the department, Masters was at the time the only nationally accredited vocational college that was trying to enter the program, receiving certification from the Accrediting Council for Independent Colleges and Schools. In the demonstration, Masters also served to represent California.

After Masters applied to join the project, the Education Department thoroughly reviewed the institution's financial-aid records, says Stephanie Babyak, a department spokeswoman The results looked good No problems developed until after Masters joined.

The department's biggest concern about Masters was that its students had a relatively high default rate on student loans, Ms. Babyak says. Masters's default rate was 26.8 percent in 1994, 22.9 percent in 1995, and 23.6 percent in 1996, the three years considered when the Education Department was choosing participants for the program (Institutions across the nation had average default rates of 10.7 percent, 10.4 percent, and 9.6 percent in those three years.)

Because the default rate did not exceed 25 percent for all three years, Ms. Babyak says, Masters was not considered a high risk But the department told Masters that it would have to develop a plan to curb loan defaults if it wanted to join the program.

The Department of Education informed the Masters Institute in June 1999 that it would be admitted into the Distance Education Demonstration Program, and the college officially joined in February 2000 Within a few months, Masters had a flood of students sign up for online courses, quickly putting its distance enrollment past the 50-percent mark.

A DOWNWARD SPIRAL

For reasons the Education Department has declined to reveal, it opened a program review of Masters in July 2000 The review, in which the financial-aid records of 70 students were audited, quickly uncovered instances of fraud

In October 2000, just eight months after Masters joined, the Education Department dropped it from the demonstration program. In a letter to Mr. Nicholaeff, Masters's chief executive officer, the department criticized the institution for the problems uncovered in the audits.

"Masters falsified attendance documents in at least five student files," states the letter, which was signed by Marianne R. Phelps, then the department's distance-education director. "While it is unclear if this constitutes the universe of falsified files, the fact that the school created fictitious documents in 5 of 70 files that had been pre-selected for its compliance audit establishes a standard of behavior that cannot be countenanced"

The department's decision had immediate consequences. Because Masters by then had more distance-education students than on-site students, the 50-percent rule meant that it could no longer offer federal financial aid to anyone—either in classroom courses or in distance programs.

Rep. Johnny Isakson, a Georgia Republican, is pushing a bill to ease aid regulations for distance education.

In December 2000, the Education Department released the results of the program review that detailed the cases of fraud. The review found 18 violations of federal regulations Among them were. failure to report fraud, failure to return financial-aid money for students who never attended, disbursement of financial aid to ineligible students, giving full-time awards to part-time students, and filing inaccurate data. The review also found that many of the records were incomplete.

Department officials presented a report about the demonstration program to Congress in January 2001—after most of the problems with the Masters Institute had been discovered but before it had exhausted a 45-day period in which to respond to the allegations So the report did not provide explicit detail about the institute's alleged fraud in the program, Ms. Babyak says Department officials later held meetings with some members of Congress and their staff members to explain what was going on with Masters. But not all congressmen found the briefings as informative as they could have been.

"This is no criticism of Secretary Riley or Secretary Paige," Mr. Isakson says, referring to former and current secretaries of education. "I don't think we got as much information as we should have, but I'm only speaking for myself."

Masters never responded to the written report, according to the Education Department. Instead, without even warning its faculty members, it shut down last March. Students in San Jose and around the country were shocked to find the doors locked and the Web site inoperable.

A BAD DECISION?

Mr. Freels, the mortgage officer who took online courses through Masters, says information about what happened to the college was difficult to come by. He found out his instructors were confused by the situation as well, finding themselves locked out when the college folded.

Because of the college's closing, the department automatically forgave—at taxpayers' expense—federal student loans taken out by Masters students. But those who paid out of pocket or received private loans had no such luck And students—some of whom had put in years of work to accumulate course credit—also found that their records were inaccessible.

Masters never declared bankruptcy, and its officers have not been charged with violating any laws, so public information about the company is hard to come by (Several lawsuits have been filed, although none have reached the courtroom yet.) But a registration assistant, Cindy Ramirez, told the *San Jose Mercury News* shortly after the college closed: "There were a lot of things being brushed under the carpet

"We were getting loans for these students who weren't attending.

"Sometimes bad things happen to good schools. And sometimes bad things happen to bad schools."

Programs weren't being tracked the way they should have been," she said. Ms. Ramirez could not be reached by *The Chronicle.*

Other observers of the debacle say the regulations should never have been waived for Masters. Deborah Godfrey is an official at the California Bureau of Private Postsecondary Vocational Education, a state agency that regulates vocational colleges She says Masters officials didn't seem to have any serious problems until they got into distance education. "I think their distance-education plan, as rapid as it was, may have been their undoing," she says.

At the time it was created, the demonstration program had 15 participants, some of them individual institutions and others consortia Later, 10 more participants joined The Masters Institute has been the only participant to develop major problems to date, according to the department.

Representative Isakson says the failure of Masters does not mean that federal regulations should not be revised And his bill, he says, includes safeguards to prevent what happened at the Masters Institute. For example, the bill would prohibit waiving the aid regulations unless an institution kept its student-loan defaults below 10 percent for the three preceding years: Masters's three-year rate had averaged nearly 25 percent

"Masters would not have been an issue if HR 1992 passed, because their default rate would have far surpassed the limit in the bill," Mr. Isakson says. "The Masters situation clearly shows that having a high threshold on default rates is critical"

But Gabriella Gomez, senior associate at the American Federation of Teachers, says Congress should be very careful about altering regulations that have worked so well The teachers' union has been skeptical in general of distance education, and wary in particular of rescinding the anti-fraud regulations without suitable replacements.

"The demonstration program is a microcosm of what's supposed to be going on nationwide," Ms. Gomez says Masters, she says, was "5 percent of the program, and multiply that across the nation and it would be a catastrophe."

But a closer look at the 15 institutions in the demonstration program shows that at only four of them did more than half of the students take courses at a distance Other institutions in the program, like Florida State University and New York University, don't even come close to hitting the 50-percent mark By that accounting, one out of the four institutions that actually used the waiver closed down The others were Capella University, Southern Christian University, and Western Governors University

The California vocational-education bureau is working with in-state students who were hurt by Masters's closure, providing them with transcripts and course transfers as well as advice on how to handle outstanding loans. But students in other states who took Masters's online courses have no recourse through any California agency. The federal Department of Education is helping those students, but the process of securing records is proving to be long and arduous.

Ms. Godfrey, of the vocational-education bureau, spends her days sorting through boxes of records for former students at Masters. She has little sympathy for its administrators.

"Sometimes bad things happen to good schools," Ms. Godfrey says. "And sometimes bad things happen to bad schools." ■