UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MEMORANDUM

MAY 21 2001

TO: Greg Woods
Chief Operating Officer
Student Financial Assistance

FROM: Lorraine Lewis

SUBJECT: FINAL AUDIT REPORT
Olivet Nazarene University, School of Graduate and Adult Studies Administration of Title IV Programs, Bourbonnais, Illinois
Control Number ED-OIG/A05-A0030

Attached is our subject report presenting our findings and recommendations resulting from our audit of the Title IV programs administered by Olivet Nazarene University's School of Graduate and Adult Studies, Bourbonnais, Illinois.

In accordance with the Department's Audit Resolution Directive, you have been designated as the action official responsible for the resolution of the finding and recommendations in this report.

If you have any questions or wish to discuss the contents of this report, please contact Richard J. Dowd, Regional Inspector General for Audit, at 312-886-6503.

Please refer to the above audit control number in all correspondence relating to this report.

Attachment

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MEMORANDUM

MAY 21 2001

TO: Maureen McLaughlin
Office of Postsecondary Education

FROM: Lorraine Lewis

SUBJECT: FINAL AUDIT REPORT
Olivet Nazarene University, School of Graduate and Adult Studies Administration of Title IV Programs, Bourbonnais, Illinois
Control Number ED-OIG/A05-A0030

Attached is our subject report presenting our findings and recommendations resulting from our audit of the Title IV programs administered by Olivet Nazarene University's School of Graduate and Adult Studies, Bourbonnais, Illinois. This report is being provided to you because of possible policy implications that may result from its issuance.

If you have any questions or wish to discuss the contents of this report, please contact Richard J. Dowd, Regional Inspector General for Audit, at 312-886-6503.

Please refer to the above audit control number in all correspondence relating to this report.

Attachment

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MA 2 1 2001

MEMORANDUM

TO: Terry Abbott
Chief of Staff
Office of the Secretary

FROM: Lorraine Lewis

SUBJECT: **FINAL AUDIT REPORT**
Olivet Nazarene University, School of Graduate and Adult Studies Administration of Title IV Programs, Bourbonnais, Illinois
Control Number ED-OIG/A05-A0030

Attached is a copy of the final audit report referenced above. We are furnishing this report to you because it may contain information of interest to you.

If you have any questions, please call Richard J. Dowd, Regional Inspector General for Audit, at 312-886-6503.

Attachment

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MEMORANDUM

MAY 21 2001

TO: Thomas P. Skelly
Director, Budget Service
Office of the Under Secretary

FROM: Lorraine Lewis

SUBJECT: **FINAL AUDIT REPORT**
Olivet Nazarene University, School of Graduate and Adult Studies Administration of Title IV Programs, Bourbonnais, Illinois
Control Number ED-OIG/A05-A0030

Attached is a copy of the final audit report referenced above. We are furnishing this report to you because it may contain information of interest to you.

If you have any questions, please call Richard J. Dowd, Regional Inspector General for Audit, at 312-886-6503.

Attachment

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-1510

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UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

CONTROL NUMBER
ED-OIG/A05-A0030

MAY 21 2001

Dr. John C. Bowling, President
Olivet Nazarene University
1 University Avenue
Bourbonnais, Illinois 60914-2271

Dear Dr. Bowling:

This **Final Audit Report** presents the results of our Audit of Commissioned Sales at Olivet Nazarene University (University). Our objective was to determine whether the University complied with the Higher Education Act's prohibition against the use of incentive payments for recruiting activities.

AUDIT RESULTS

We found that the University violated the statutory prohibition on the use of incentive payments for recruiting based on success in securing student enrollments when it paid the Institute for Professional Development (IPD) a percentage of tuition for all students enrolled in four School of Graduate and Adult Studies programs (SGAS programs).

The University entered into a contract with IPD. The contract called for IPD to receive payments based on the number of students enrolled in the SGAS programs. The Higher Education Act (HEA) expressly prohibits any type of incentive payment based directly or indirectly on success in securing enrollments. As a result of incentive payments to IPD, the University is liable for all Title IV funds awarded to students in the SGAS programs.

Institutions Participating in the Title IV Programs Must Not Provide Payments for Securing Enrollments

Sections 487(a) and 487(a)(20) of the HEA require that:

> In order to be an eligible institution for the purposes of any program authorized under this title, an institution . . . shall . . . enter into a program participation agreement with the Secretary. The agreement shall condition the initial and continuing eligibility of an institution to participate in a program upon compliance with the following requirements:

> . . . The institution will not provide any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to any persons or entities engaged in any student recruiting or admission activities or in making decisions regarding the award of student financial assistance . . . .

The regulations at 34 Code of Federal Regulations (CFR) § 668.14(b)(22) codify the statutory prohibition on incentive payments based on securing enrollment.

> By entering into this program participation agreement, an institution agrees that . . . it will not provide, nor contract with any entity that provides, any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to any persons or entities engaged in any student recruiting or admission activities or in making decisions regarding the awarding of student financial assistance.

IPD Received Payments Based on Student Enrollment in the SGAS Programs

The University entered into a contract with IPD that provided for incentive payments to IPD based on success in securing student enrollments for its SGAS programs. The contract included the following specific responsibilities for IPD:

- IPD shall recruit students to enroll in the courses of study in the SGAS programs.
- IPD shall provide representatives to recruit students for the programs covered under the agreement.
- IPD will submit to the University a sufficient number of qualified applicants for admission to the programs such that a minimum of 100 and a maximum of 1,800 students are enrolled in courses of study during each academic year.
- IPD shall collect, on behalf of the University, all tuition, application fees, book and material fees, and other fees applicable to the programs.
- IPD shall maintain the official program accounting books and records.

IPD remitted book, material, and computer fees in full to the University. Tuition fees were divided between the parties on a weekly basis. During the period of our audit, in accordance with the contract, the division was 50 percent to the University and 50 percent to IPD. Refunds were paid from the joint account according to these percentages.

The University Violated the HEA by Paying IPD Based on Success in Securing Enrollments for the SGAS Programs Which Resulted in $3,161,750 of Improperly Disbursed Title IV Funds

Because the University did not comply with the HEA and regulations by paying incentives to IPD based on success in securing enrollments for its SGAS programs, the University must return all Title IV funds that were disbursed on behalf of students enrolled in the SGAS programs. Because the University paid incentives for each student enrolled in the SGAS programs, all students in the SGAS programs were improperly recruited. Our audit covered the period July 1, 1996, through June 30, 1999. For that period, Title IV funds totaling $3,299,891 were disbursed on behalf of students enrolled in the SGAS programs, consisting of $2,000 in Federal Perkins Loans (Perkins), $18,740 in Federal Supplemental Educational Opportunity Grants (FSEOG), $137,901 in Federal Pell Grants (Pell), and $3,141,250 in Federal Family Educational Loans (FFEL) funds.

IPD's Compensation Plan for Recruiters Based Salary and Bonuses on the Number of Students Enrolled in the SGAS Programs

Our review of IPD's compensation plans for fiscal years (FY) 1997-1999 disclosed that IPD provided incentives to its recruiters through salary levels that were based on the number of students recruited and enrolled in the programs. IPD assigned recruiters a salary within the parameters of performance guidelines (i.e., knowledge of basic policies and procedures, organization and communication skills, and working relationships). IPD assessed recruiter performance on a regular basis, comparing it to the established goals for the fiscal year. IPD completed formal evaluations biannually and, after the first 6 months of employment, determined salary on an annual basis. The recruiter's success in enrolling students determined whether IPD adjusted the salary upward, downward, or kept it the same. In addition, the FY 1998 and 1999 compensation plans called for the payment of bonuses to recruiters hired before September 1, 1998. The bonuses increased as the number of students increased, and ranged from $1,344 for 100-149 students to $29,600 for over 200 students. The FY 1999 plan indicated that recruiters hired on or after September 1, 1998, who achieved 100 or more starts by the end of the fiscal year were entitled to a one-time bonus of $1,500.

Recommendations

We recommend that the Chief Operating Officer for Student Financial Assistance require the University to:

1. Amend and/or terminate immediately its present contractual relationship with IPD to eliminate incentive payments based on success in securing enrollments.

2. Return to lenders $3,141,250 of FFEL disbursed on behalf of students enrolled in the SGAS programs during the period July 1, 1996, through June 30, 1999, and repay the Department for interest and special allowance costs incurred on Federally subsidized loans.

3. Return to the Department $2,000 of Perkins, $18,740 of FSEOG, and $137,901 of Pell disbursed to students enrolled in the SGAS programs during the period July 1, 1996, through June 30, 1999.

4. Determine the amount of Perkins, FSEOG, Pell and FFEL funds improperly disbursed to or on behalf of students since the end of our audit period and return the funds to the Department and lenders.

University Comments and OIG Response

The University did not agree with our conclusions and recommendations. The following is a summary of the University's comments and our response to the comments. The full text of the University's comments is attached.

University Comments. **The Allocation of Revenue Under the IPD Contract Does Not Violate the Incentive Compensation Rule**. The University stated that:

- The IPD contract compensates IPD based on the volume of a broad range of professional services provided to Olivet Nazarene University, many of which have variable costs dependent on the number of students.
- The Incentive Compensation Rule does not apply to the IPD contract because (1) the Department is without legal authority to use the rule as a basis for regulating routine contracts for professional, non-enrollment related services; and (2) the rule cannot apply to service contracts where the cost of providing services necessarily varies depending on the number of students.
- The IPD contract provides that IPD receives decreasing percentages of revenues as more students enrolled in SGAS programs.
- The University's compensation to IPD does not constitute a "commission, bonus, or other incentive payment based directly or indirectly on success in securing student enrollments."
- The Department has published no regulation or other public guidance supporting the interpretation of revenue-sharing arrangements advanced by the OIG in the draft report.

The IPD Contract Compensates IPD Based on the Volume of a Broad Range of Professional Services Provided to Olivet Nazarene University. The University stated that the contract commits IPD to provide the following list of services, which it performed, with respect to the operation of the SGAS programs.

- Management consultation and training, upon request, regarding:
  - Program administration and evaluation.
  - Assessment center organization and management.
  - Student tracking systems development and implementation.
  - Marketing research and management.
  - Student tuition and financial aid accounting.
  - Faculty recruitment, assessment, and development.
  - Ongoing curriculum review and revision.
- Curriculum delivery system development.

- Faculty and student curriculum material development.
- Maintenance of accounting records, and financial planning and budgeting.
- Recruitment and screening of potential SGAS faculty.
- Administrative facilities lease management.

The University stated that the OIG implied that IPD only provided recruiting and tuition collection services and the OIG either overlooked or ignored other services provided by IPD under the agreement with the University.

OIG Response**.** The OIG did not overlook or ignore the fact that IPD provided other services to the University under the terms of the agreement. In the draft audit report, we acknowledged that IPD provided additional services, such as accounting. Because it was not within the scope of our audit, we did not determine the extent of additional services under the agreement that IPD actually provided at the request of the University and at IPD's cost. We did verify that the revenue to IPD was generated only by the success in securing enrollments for which IPD was performing recruiting services. This constitutes the statutory violation of providing a commission, bonus, or other incentive payment based directly or indirectly on the success in securing enrollments.

While we recognize that IPD logically had to incur expenses to provide the program accounting services and any additional services that it may have provided, these expenses are irrelevant in determining whether the structure of the revenue allocation is a violation of the HEA. No compensation was to be provided to IPD unless IPD was successful in recruiting and securing student enrollments. The agreement also included a minimum enrollment guarantee that, if not achieved, would result in a reduction in revenue to be allocated to IPD, despite other services that might have been provided. This further emphasizes that the revenue stream is completely generated by, and depended on, student enrollment.

The University does not dispute that the payments it made to IPD were based on a percentage of the tuition and fees paid by students enrolled in the SGAS. Likewise, the University does not dispute that IPD was responsible for recruiting students. Nor does the University dispute that some portion of the amount it paid to IPD was directly related to IPD's success in securing enrollments for the University's SGAS. Our audit report did not focus on what other services may have been provided by IPD because once IPD became responsible for recruiting students, even among other activities, and received compensation from the University based on the number of students enrolled in the program, the University was in violation of the HEA.

The HEA at § 487(a)(20) states:

> The Institution will not provide **any** commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to **any persons or entities engaged in any student recruiting** . . . [Emphasis added.]

Once recruiting was added to the services to be provided under the contract, compensation based on enrollment was no longer permitted. IPD had sole responsibility for recruitment and

enrollment, and was paid under the contract only on the basis of its success in securing student enrollment regardless of what other services it may have been providing. Whether or not the revenue allocation was intended to provide compensation for other services is irrelevant because the allocation violates the law.

The University's response regarding the services performed by IPD does not always agree with the contract.

Where the University puts forward that IPD was responsible for program administration and evaluation, the contract actually provided that "[the University] retails full and ultimate responsibility to third parties for the educational content, instruction, and presentation of the courses of study offered in the programs." Section III. D. of the contract stated that IPD shall provide, at IPD's expense, reasonable consulting services to train University personnel in program administration and evaluation.

The University, in its response, stated that IPD is responsible for student services and academic services procedures. As explained below, these services were to be provided at the University's request and IPD's expense, or under separate agreement.

The University stated that IPD was responsible for curriculum development. The contract at Section III. E., Curriculum Delivery System actually stated that "IPD, in its role as consultant, shall assist Olivet Nazarene University in the preparation of full descriptions of curricula . . . ." The contract stated that all faculty and student curriculum materials developed by University faculty or IPD for delivery in the programs shall be paid for by IPD in accordance with preexisting payment schedules. The printing and distribution of the curriculum materials shall be the responsibility of the University.

The University's response asserted that IPD was responsible for faculty recruitment and assessment. The contract actually stated that "IPD shall, if requested by Olivet Nazarene University, assist Olivet Nazarene University to recruit, screen and recommend for Olivet Nazarene University consideration or approval and appointment, all instructors and faculty advisors required for participation in the programs."

As provided for in the contract, Section III. G., IPD may offer suggested class sites; however, the University was to determine actual sites, and shall procure and be responsible for these sites.

We had previously reported that IPD maintained the official accounting records of the program. In its response, the University stated that IPD is also responsible for financial planning and budgeting. We find no reference to these duties in the contract.

The contract did require IPD to provide all program promotion and advertising. Successful program promotions, advertising and market research by IPD would have the effect of increasing its success in securing enrollments for which it was compensated. We had previously included this in the background section of our report.

The University stated that all of the services offered by IPD were highly volume sensitive. We could only identify three items from the contract that appear to be volume sensitive: recruiting, marketing, and maintenance of accounting records. The array of consulting services would not necessarily be volume sensitive.

University Comments. **The Incentive Compensation Rule Does Not Apply to the IPD Contract Because (1) the Department is Without Legal Authority to Use the Rule as a Basis for Regulating Routine Contracts for Professional, Non-Enrollment Related Services; and (2) the Rule Cannot Apply to Service Contracts Where the Cost of Providing Services Necessarily Varies Depending on the Number of Students**. The University stated that the Incentive Compensation Rule was intended to prevent schools from using commissioned salespersons to recruit students, not to regulate business arrangements. When Congress enacted the statute, and the Department promulgated the implementing regulation, both emphasized their intention to halt the use of commissioned salespersons as recruiters.

OIG Response. The HEA does not excuse or permit incentive payments depending on the type of contractual arrangement that creates them. Any incentive payment based directly or indirectly on success in securing enrollment is prohibited. The contract with IPD included recruiting activities with compensation determined by IPD's success in securing students for enrollment, on a per student basis.

University Comments. **The IPD Contract Provides That IPD Receives Decreasing Percentages of Revenues as More Students Enrolled in SGAS Programs**. The University stated that even with the broad range of services to be performed by IPD, economies of scale justified allocation of a lesser percentage once the SGAS programs reached various participation thresholds. The University claimed that economies of scale enabled IPD to perform the wide-range of services at a lesser cost and pass these savings on to the University in the form of a reduced percentage of revenue at a larger volume of work performed.

OIG Response. The reduction in the incentive package upon reaching certain enrollment levels does not negate the conclusion that the revenue allocation (at whatever percentage) is an improper incentive. The incentive does not become proper by being reduced below a certain percentage amount. Regardless of the percentage amount, IPD was paid additional compensation directly tied to each additional enrollment.

University Comments. **The University's Compensation to IPD Does Not Constitute a Commission, Bonus, or Other Incentive Payment Based Directly or Indirectly on Success in Securing Student Enrollments. The Department Has Published No Regulation or Other Public Guidance Supporting the OIG's Interpretation of the Incentive Compensation Rule to Restrict Routine Revenue-Sharing Arrangements**. The University stated that the draft report cites no regulatory guidance, case law, nor other published guidance to support the proposition that the revenue allocation formula violates the Incentive Compensation Rule. The University did not know, and could not have known, that the revenue allocation formula would be construed as a violation of the Incentive Compensation Rule, because no such pronouncement or interpretation had ever been published and disseminated to Title IV-participating institutions. The University stated that revenue received by IPD did not meet the definition of commissions or bonuses, and was not paid to any individual agent or employee.

OIG Response. The HEA prohibition, § 487(a)(20), on incentive payments is clear.

> The Institution will not provide **any** commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to **any persons or entities engaged in any student recruiting**. . . . [Emphasis added.]

The University signed a program participation agreement committing it to comply with the HEA and regulations. The contract clearly indicated that IPD was to be an entity engaged in student recruiting on behalf of the University. The contract also clearly showed that compensation to IPD was a percentage of the tuition revenue based on IPD's success in securing student enrollments for the University.

University Comments. **The OIG's Recommended Sanction – Disallowance of All Title IV Funds Received by the University for SGAS Enrollees – Is Unwarrented [sic] and Inconsistent With Applicable Law and Regulations**. The University stated that no basis exists to support that a violation of any of the innumerable program participation agreement requirements warrants a wholesale disallowance of all Title IV funds.

OIG Response. The University incorrectly characterized our recommendation for monetary recovery as a sanction. We are not proposing that the University be fined. We are recommending that the Department recover funds disbursed in violation of the HEA.

University Comments. **IPD's Recruiter Salaries Do Not Violate the Incentive Compensation Rule**. IPD stated that its compensation plans based recruiter salaries on factors or qualities that are not solely related to success in securing enrollments. It also stated that the prohibition in § 487(a)(20) did not extend to salaries. Even if salaries were included, IPD stated that salaries could be based on merit or success in securing enrollment as long as enrollment was not the sole factor.

OIG's Response. Contrary to IPD's representation, the compensation plan we reviewed did not include factors other than enrollment to adjust recruiter salaries. According to the compensation plan, recruiters' salary and bonuses were determined annually by how many students they enrolled in the programs. Annual salary and bonuses would increase, decrease, or remain the same in accordance with predetermined tables that directly tied students enrolled to particular salary and bonus amounts. The salary and bonus tables did not include factors other than enrollment. The requirements of § 487(a)(20) cannot be avoided by labeling improper incentive compensation as salary.

OTHER MATTERS

During our audit work, we also identified an issue relating to the University's definition of an academic year for its undergraduate SGAS programs under the 12 Hour-Rule, which will be addressed in a separate report.

BACKGROUND

Founded in 1907, the University is a liberal arts university with its main campus in Bourbonnais, Illinois. The North Central Association of Colleges and Schools accredits it to offer Associate, Baccalaureate, and Masters degrees. In 1949, the University began to provide adult education when its North Central Association Studies Committee [sic] recommended that it place an increased emphasis on adult education and "the opportunities for lifelong learning."

On October 17, 1989, the University contracted with IPD, a subsidiary of the Apollo Corporation, to help improve its existing School of Graduate and Adult Studies. As a result, the University added Baccalaureate degree programs in Management, Nursing, and Business Administration to the SGAS, and revised its existing Masters of Business Administration program. The University contracted with IPD for marketing and accounting support, while it provided the curriculum, facilities, and faculty. The University and IPD split tuition revenue equally, but the University received 100 percent of book, material, computer, and other miscellaneous fees.

During the period July 1, 1996, through June 30, 1999, the University participated in the Perkins, FSEOG, Pell, and FFEL programs. University or Department records indicated that, during the period, the University or lenders disbursed $3,299,891 on behalf of students in the SGAS programs. Specifically, the University's records indicated that it disbursed Perkins totaling $2,000 and FSEOG totaling $18,740. The Department's records (Student Payment Summary for Pell and National Student Loan Data System for FFEL) indicated the University disbursed Pell totaling $137,901 and lenders disbursed FFEL of $3,141,250. Title IV of the HEA of 1965, as amended, authorizes these programs, and they are governed by regulations contained in 34 CFR Parts 674, 676, 682, and 690, respectively. In addition, these programs are subject to the provisions contained in the Student Assistance General Provisions regulations (34 CFR Part 668), and the University must comply with the Institutional Eligibility regulations (34 CFR Part 600) to participate in these programs. Regulatory citations in the report are to the codifications revised as of July 1, 1996, 1997, and 1998.

AUDIT SCOPE AND METHODOLOGY

The audit's objective was to determine whether the University complied with the HEA and Title IV regulations concerning the prohibition on making incentive payments based on success in enrolling students. We specifically focused our review on the University's contract with IPD and the programs of study related to that contract.

To accomplish our objective, we reviewed the University's written policies and procedures, accounting and bank records, and student financial assistance reports. We reviewed the University's program participation agreement with the Department, its contract with IPD, and IPD's compensation plan for its recruiters. In addition, we reviewed single audit reports prepared by the University's Certified Public Accountants.

We relied on computer-processed data the University extracted from its financial assistance database. We used award and disbursement data from the Department's Student Payment Summary and National Student Loan Data System to corroborate information obtained from the University. We did this by comparing Pell and loan disbursements for all students in the Department's records with University data. We held discussions with University officials to gain an understanding of the processes for requesting and drawing down Federal funds, and for its accounting for revenue from the SGAS programs. Based on these tests and assessments, we concluded that the data the University provided were sufficiently reliable to use in meeting the audit's objectives.

The audit covered the period July 1, 1996, through June 30, 1999. We performed the on-site field work in Bourbonnais, Illinois, during the periods August 15-25, September 6, and September 29, 2000. We conducted the audit in accordance with government auditing standards appropriate to the scope of review stated above.

STATEMENT ON MANAGEMENT CONTROLS

As a part of our review, we gained an understanding of the University's management control structure, as well as its policies, procedures, and practices applicable to the scope of the audit. We identified applicable significant controls related to institutional eligibility, student enrollment, and contract payments. To determine the level of control risk, we initially tested disbursements to 55 Pell and 117 loan recipients. Subsequently, we decided to compare Pell and loan transactions for all students in the SGAS programs.

Due to inherent limitations, a study and evaluation made for the limited purpose stated above would not necessarily disclose all material weaknesses in the management controls. However, we identified a significant weakness over incentive payments for student enrollment that violated the statutory prohibition against commissioned sales. The Audit Results section of this report fully discusses this weakness and its effect.

ADMINISTRATIVE MATTERS

If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Department of Education official, who will consider them before taking final action on the audit:

Greg Woods, Chief Operating Officer
Student Financial Assistance
Regional Office Building, 7th and D Streets, S.W.
ROB Room 4004, Mail Stop 5132
Washington, DC 20202

Office of Management and Budget Circular A-50 directs Federal agencies to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within 30 days would be greatly appreciated.

In accordance with the Freedom of Information Act (5 U.S.C. §552), reports issued by the Office of Inspector General are available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

If you have any questions or wish to discuss the contents of this report, please contact Richard J. Dowd, Regional Inspector General for Audit, Chicago, Illinois, at (312)886-6503. Please refer to the control number in all correspondence relating to this report.

Sincerely,

Lorraine Lewis

Attachment

Olivet
Nazarene University

February 23, 2001

Mr. Richard J. Dowd
Regional Inspector General for Audit - Region V
U.S. Department of Education
Office of Inspector General
111 N. Canal Street, Suite 940
Chicago, IL 60606

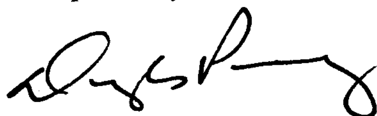
RE: Draft Audit Report; Olivet Nazarene University (Control Number ED-OIG/A05-A0030)

Dear Mr. Dowd:

Attached please find Olivet Nazarene University's response to the Draft Audit Report issued on January 2, 2001 by the United States Department of Education, Office of Inspector General, Division of Audit. For all of the reasons presented therein, the University does not concur with the Findings and Recommendations set forth in the Draft Report.

We appreciate the opportunity to comment on the Draft Report, and the University reserves the right and opportunity to respond further to any final report as may be issued.

Respectfully submitted,



Dr. Douglas E. Perry
Vice President for Finance

Attachment

Olivet Nazarene University
Bourbonnais, Illinois 60914-2271
Telephone (815) 939-5011

OLIVET NAZARENE UNIVERSITY'S RESPONSE TO THE DRAFT AUDIT REPORT OF THE U.S. DEPARTMENT OF EDUCATION OFFICE OF INSPECTOR GENERAL (Control Number ED-OIG/A05-A0030)

Olivet Nazarene University (the "University, or "ONU") is a private, not-for-profit, liberal arts university founded in 1907. Located in the historic village of Bourbonnais, Illinois, the University is sponsored by the Church of Nazarene and is comprised of approximately 2,400 students (1,800 undergraduates) from 36 states and 20 countries, representing more than 30 religious denominations. The University is accredited by the North Central Association of Colleges and Schools, the National League for Nursing, the American Dietetics Association, the Council on Social Work Education, and the National Association of Schools of Music, among others. The University has consistently maintained low cohort default rates: 3.1 percent in Fiscal Year ("FY") 1998, 4.8 percent in FY 1997, and 7.2 percent in FY 1996.

The Draft Audit Report focuses upon federal student financial aid funds ("Title IV funds") received by students who enrolled in ONU's School of Graduate and Adult Studies ("SGAS") programs. The University offers its SGAS programs through a contract with an independent outside entity, the Institute for Professional Development ("IPD"). The issues raised by the Draft Audit Report all pertain to that "Agreement between Olivet Nazarene University and Institute for Professional Development," signed October 17, 1989 (the "IPD Contract").

The University maintains that the IPD Contract's revenue allocation provisions do not violate the Incentive Compensation Rule. In addition, the Office of Inspector General's ("OIG") recommendation that the University return all Title IV funding disbursed for the SGAS programs is an extreme, unjustified, and arbitrary proposed sanction without support in applicable law or regulations. Finally, IPD maintains that its recruiter salaries do not violate the Incentive Compensation Rule.

I. THE ALLOCATION OF REVENUE UNDER THE IPD CONTRACT DOES NOT VIOLATE THE INCENTIVE COMPENSATION RULE.

The Draft Report erroneously claims that the revenue allocation provision of the IPD Contract is prohibited. This claim is based on the OIG's allegation that the University paid "incentives to IPD based on success in securing student enrollments for its SGAS programs." The University vigorously disagrees with both the draft finding and recommendation, for each of the following reasons:

- The IPD Contract compensates IPD based on the volume of a broad range of professional services provided to Olivet Nazarene University, many of which have variable costs dependant on the number of students.
- The Incentive Compensation Rule does not apply to the IPD Contract because (1) the Department is without legal authority to use the rule as a basis for regulating routine contracts for professional, non-enrollment related services; and (2) the rule cannot apply to service contracts where the cost of providing services necessarily varies depending on the number of students.

- The IPD Contract provides that IPD receives decreasing percentages of revenues as more students enrolled in SGAS programs.
- The University's compensation to IPD does not constitute a "commission, bonus, or other incentive payment based directly or indirectly on success in securing student enrollments."
- The Department has published no regulation or other public guidance supporting the interpretation of revenue-sharing arrangements advanced by the OIG in the Draft Report.

For each of the foregoing reasons, as discussed in greater detail below, the University strenuously disagrees with the Draft Audit Report's findings and recommendations regarding to the IPD Contract.

A. The IPD Contract compensates IPD based on the volume of a broad range of professional services provided to Olivet Nazarene University.

In the present case, the IPD Contract commits IPD to provide the following broad range of services, which it did, in regard to the operation of the SGAS programs:

- Management consultation and training, upon request, regarding:
  - Program administration and evaluation;
  - Assessment center organization and management;
  - Faculty recruitment, assessment, and development;
  - Student tracking systems development and implementation;
  - Marketing research and management;
  - Student tuition and financial aid accounting;
  - Faculty recruitment and assessment;
  - Ongoing curriculum review and revision;
- Curriculum delivery system development;
- Faculty and student curriculum material development;
- Maintenance of accounting records, and financial planning and budgeting;
- Recruitment and screening of potential SGAS faculty;
- Administrative facilities lease management.

The OIG fails to consider each of the non-enrollment related services performed by IPD under the contract, and instead isolates and discusses only recruitment and student accounting functions attributable to IPD. See Draft Audit Report at page 2. In doing so, the OIG wrongly implies that recruitment and tuition collections constituted IPD's only functions with respect to the SGAS programs. Id. In addition, the OIG ignores the fact that the overall cost to any vendor of providing many of the above services is highly dependent on the volume required, which is, in turn, dependent on the numbers of students at the institution. The IPD Contract therefore simply

allocates revenues to reimburse IPD for additional services provided to the University as its demand for services increases.[1]

Based on an erroneously narrow view of IPD's responsibilities and a summary rejection of the basic notion that additional SGAS students cause higher IPD expenses, the Draft Audit Report incorrectly concludes that any amounts paid by the University to IPD was in consideration for "securing student enrollments for [the] SGAS programs," and for no other functions whatsoever. Id. The IPD Contract, however, reflects that the allocation of SGAS revenues is based a wide range of non-enrollment based academic and administration functions, in addition to the limited items identified in the Draft Audit Report. If the OIG auditors unintentionally overlooked these additional IPD responsibilities in the course of the their review, the audit procedures were incomplete and therefore flawed. However, if the auditors were aware of these additional IPD services and chose to ignore them, the Draft Audit Report is flawed in a manner that raises questions about the impartiality of the process.

B. The Incentive Compensation Rule does not apply to the IPD Contract.

1. The Department has no legal authority for using the Incentive Compensation Rule as a basis for regulating routine contracts for professional, non-enrollment related services.

Section 487(a) of the Higher Education Act of 1965, as amended (the "HEA"), requires institutions participating in the Title IV programs to enter into a Program Participation Agreement ("PPA") that provides for such institutions to comply with a long laundry list of requirements. The twentieth item on the list states:

> The institution will not provide any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to any persons or entities engaged in any student recruiting or admission activities or in making decisions regarding the award of student financial assistance.

20 U.S.C. § 1094(a)(20). The implementing regulation promulgated by the U.S. Department of Education ("the Department" or "ED") in turn requires Title IV, HEA participating institutions to agree as follows:

> [The institution] will not provide, nor contract with any entity that provides, any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to any

[1] This aspect of the IPD Contract is discussed in greater detail in Section B.2, infra.

> persons or entities engaged in any student recruiting or admission activities or in making decisions regarding the awarding of student financial assistance.

34 C.F.R. § 668.14(b)(22). It is plain from the express language of both provisions that the Incentive Compensation Rule was intended to prevent schools from using commissioned salespersons to recruit students, not to regulate business arrangements such as the one described in this Draft Audit Report, which cover a wide array of professional services. The legislative and regulatory histories also emphasize an intention to halt the use of commissioned salespersons as recruiters. Congress explained:

> The conferees note that substantial program abuse has occurred in the student aid programs with respect to the use of commissioned sales representatives. Therefore this legislation will prohibit their use.

Conf. Rep. No. 102-630, 102d Cong., 2d Sess. 499 (1992). Similarly, the Secretary's published commentary accompanying the final regulation stated:

> The Secretary believes that this provision is necessary to implement more rigid restrictions than were seen in the past on the practices of "commissioned salespersons."

59 Fed. Reg. 9539 (February 28, 1994). There is simply nothing in either legislative and regulatory history to support the Incentive Compensation Rule as a basis for the Department to regulate institutions' routine business arrangements with outside vendors where services are contracted for at a set rate of compensation, which is based on the volume of services provided, such as the contract between ONU and IPD.[2]

2. <u>The Incentive Compensation Rule cannot apply to service contracts where the cost of providing services necessarily varies depending on the number of students.</u>

The array of professional services delineated in the IPD Contract, and performed accordingly, demonstrates that the partial allocation of revenues to IPD does not constitute incentive compensation attributable to enrollments, but instead is simply an equitable payment mechanism designed to account for the amount of work required of IPD in serving SGAS students. The magnitude of IPD's various functions and obligations under the contract depends in substantial part upon how many students enroll in the SGAS programs that IPD designed,

[2] Notably, in contrast to the regulations later promulgated by ED, section 487(a) of the HEA makes no reference to contracts between educational institutions and outside entities.

developed, and administered for the University. Indeed, many of the tasks assigned to IPD by the IPD Contract are highly volume sensitive. Therefore, because the parties could not predict how many students would enroll, they similarly could not predict how much work the IPD contract would entail. To account for this uncertainty in their business arrangement, the IPD Contract allocates revenue in a manner that compensates IPD on a basis roughly parallel to the scope and quantity of the required services. IPD's compensation is premised on the full scope of work to be performed for the University, not on IPD's success in enrolling any students in the SGAS programs.

In contrast, the OIG would apparently disallow any payment arrangement between an institution and professional service provider that reflects indefinite quantities. This interpretation is flawed because the Incentive Compensation Rule applies to individual employees with a finite amount of time in which to perform job functions. However, for a professional services vendor that can employee more people and buy more resources to meet demand or increase productivity, there is no finite time resource as there is with individual employees. Therefore, if a vendor expands the level of services under a contract where demand is increasing, as in this case, it is reasonable to provide the vendor with more total compensation to offset the greater workload and need for more employees. These economic precepts dictate that the Incentive Compensation Rule can apply only to the compensation of individuals employed by the institution or the vendor. The rule cannot apply to payments made by an institution to a vendor for professional services rendered pursuant to contract of indefinite quantities.[3]

C. The IPD Contract provides that IPD receives <u>decreasing</u> percentages of revenues as more students enrolled in SGAS programs.

The Draft Audit Report fails to consider that the University allocates IPD a <u>decreasing</u> percentage of overall SGAS revenues as the number of enrollments increases.[4] This fact contradicts the OIG claim that IPD's compensation rights were linked to increased enrollment. In fact, the declining payment percentages indicate that the revenue allocation is tied directly to IPD's increased costs of providing various non-enrollment services, which due to economy of scale, rise in smaller increments as the SGAS student population passes certain threshold levels. As the number of SGAS students increased, IPD was able to perform its administrative, academic, and other contractual responsibilities at a lower per-capita cost, enabling it to share such savings with the University. Those savings were not attributable to the recruitment and marketing

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[3] The OIG's interpretation creates a situation whereby smaller institutions cannot contract with outside vendors to assist with developing non-traditional educational delivery systems. Only larger institutions, with far more resources and internal capacity, will be able to effectively offer non-traditional programs of high quality.

[4] During the audit period, the IPD Contract allocated 50 percent of SGAS revenues to IPD. However, that percentage share would decrease to 45 percent in any academic year following an academic year in which SGAS enrollment exceeded 400 students, 40 percent when over 600 students, 35 percent when over 800 students, 30 percent when over 1100 students, and 25 percent when enrollments passed 1400 students. <u>See</u> IPD Contract at 19-20.

functions. If the allocation of revenue was intended to pay IPD for recruiting and enrollment services, and for nothing more, the IPD Contract would not have required a decreasing percentage share, or it would have increased IPD's percentage share as enrollments increased.

D. The University's compensation to IPD does not constitute a "commission, bonus, or other incentive payment based directly or indirectly on success in securing student enrollments."

1. The allocation of revenue to IPD does not constitute commissions or bonuses tied to enrollments.

Blacks Law Dictionary (6th ed. 1990) defines "bonus" as "an extra consideration given for what is received, or something given in addition to what is ordinarily received by, or strictly due, the recipient." It defines "commission" as "a fee paid to an agent or employee for transacting a piece of business or performing a service." On its face, the bonus definition does not apply to the allocation of revenue between ONU and IPD because those payments constitute the sole compensation to IPD for services performed pursuant to the IPD Contract. The revenue allocation is not supplemental compensation. Similarly, the allocations do not constitute enrollment-based commissions because (a) as has been shown, IPD is compensated for the wide variety of services it performs in regard to the SGAS programs, not merely for marketing; (b) the allocation of revenues does not compensate IPD for any specific transaction, but instead pay for the full scope of services provided under the IPD Contract; and (c) the revenue is allocated to IPD as a corporate entity; there are no payments under the IPD Contract to any individual "agent or employee" based upon specific transactions or recruitment activities.

2. The allocation of revenue to IPD does not constitute incentive payments.

The statute and regulations forbid payment of "any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments" (emphasis added).[5] Webster's 3d New International Dictionary (1981) defines the word "incentive," when used as an adjective, as "serving to encourage, rouse, or move to action." As described above, IPD's percentage share of SGAS revenues actually decreases as enrollment increases. Moreover, the revenue allocation is a means of achieving equitable compensation for a broad array of professional services. The revenue allocation does not motivate or incite enrollments.

[5] By inserting the word, "other," before "incentive payment," Congress and ED made clear that only those commissions, bonuses, or other payments that constitute incentive payments are prohibited.

E. The Department has published no regulation or other public guidance supporting the OIG's interpretation of the Incentive Compensation Rule to restrict routine revenue sharing arrangements.

The Draft Audit Report cites no case precedent, regulatory or non-regulatory guidance, or other legal authority to support the proposition that the allocation of revenue under the IPD Contract violates the Incentive Compensation Rule. This attempt by the OIG to retroactively create and apply a new requirement to ONU raises serious due process concerns. Namely, parties that are regulated by the Department, or by any other administrative agency, are entitled to adequate notice of what rules are to be applied to them. In this case, the University did not know, and could not have known, that the allocation of revenue in the IPD Contract would be construed as a violation of the Incentive Compensation Rule, because no such pronouncement or interpretation had ever been published and disseminated to Title IV-participating institutions. Indeed, for all of the reasons presented in this submission, this University and many others like it reasonably believed the opposite.[6] We further submit that the interpretation advanced by the OIG in the Draft Report is so removed from a reasonable person's understanding of the regulations that the University cannot be deemed to have been fairly informed of any such agency perspective. Imposition of a multi-million dollar liability under this dubious, retroactively applied policy interpretation violates traditional notions of due process and fair play because the University did not have adequate notice that its conduct would be deemed prohibited.

Moreover, to the best of the University's knowledge, despite the emergence nationally of revenue sharing and similar type contractual understandings between higher education institutions and outside vendors, the Department has not previously applied this rule in this manner to any institution, and the OIG has provided no justification or legal authority for selectively enforcing its own policy interpretation against the University. We respectfully suggest that such action is arbitrary and capricious because a regulatory agency must provide an adequate explanation before it treats similarly situated parties differently.

For all of the foregoing reasons, the University vigorously disagrees with the Draft Audit Report's findings and recommendations with respect to the IPD Contract. We urge the OIG to rescind the draft finding and recommendation and to forego issuance of any final report, or to delete both from any final report.

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[6] The issues raised herein do not challenge the authority of ED, through notice-and-comment rulemaking, to promulgate regulations governing revenue-sharing agreements between Title IV participating institutions and other entities. Unlike regulations issued through that formal administrative process, which may be challenged but are entitled to deference, the regulatory interpretation at issue in this case was developed surreptitiously by the OIG and is therefore owed no deference. Moreover, the OIG's policymaking initiative falls outside the scope of the OIG's authority under the Inspector General Act of 1978, which precludes an agency from delegating "program operating responsibilities" to an OIG.

II. THE OIG'S RECOMMENDATION -- DISALLOWANCE OF ALL TITLE IV FUNDS RECEIVED BY THE UNIVERSITY FOR SGAS ENROLLEES -- IS UNWARRENTED AND IS INCONSISTENT WITH APPLICABLE LAW AND REGULATIONS.

The Draft Audit Report erroneously asserts at page 3 that "because the University did not comply with the HEA and regulations by paying incentives to IPD based on success in securing student enrollments for its SGAS programs, the University must return all Title IV funds that were disbursed on behalf of students enrolled in the SGAS programs." On these grounds, the Report later asserts that a staggering dollar figure -- $3,161,750, representing the principal amount of all Title IV loans and grants received by SGAS enrollees -- should be returned to lenders and to the U.S. Department of Education.

The University strenuously objects to the recommended sanctions presented in the Draft Audit Report. First, as has been previously stated, we disagree with the OIG's assertion that the allocation of revenue under the IPD Contract constitutes payment of prohibited incentives to IPD. Because the OIG cites that assertion as the basis for the recommended sanctions, we believe that no sanctions are warranted. Second, even if the OIG's allegations had merit, the violations asserted would not trigger the extreme wholesale disallowance that is recommended. The OIG offers neither legal authority nor analysis to justify or explain why disallowance of all SGAS-related financial aid funding would lawfully, logically, or reasonably result from the cited noncompliance.

In the absence of any OIG statement of reasons, the University cannot presently submit any comprehensive response to the recommended sanction. We therefore reserve the right and opportunity to respond at a later date, if and when such a statement is presented. In the meantime, we can offer the following preliminary statement of reasons why the recommended sanction is unjustified and should be deleted from any final audit report:

1. The extraordinary recommended monetary sanction – wholesale disallowance of more than three million dollars, representing all federal funds received by students enrolled in the SGAS programs – is facially arbitrary and capricious because: a) the Draft Audit Report does not explain the basis for the recommendation; b) no statute, regulation, or other published guidance imposes wholesale disallowance based upon violation of the Incentive Compensation Rule; and c) various ED rules and precedents articulate a variety of lesser sanctions. The recommended sanction should be deleted because the Draft Audit Report does not, and can not, explain any basis for a wholesale disallowance of aid to eligible students, and because the OIG has not considered, much less rejected with reasons, any of the available lesser alternatives.

2. The SGAS program funds targeted by the OIG for disallowance were utilized by the University and its SGAS students for their lawful intended purposes, i.e., to pay the costs of attendance associated with these students' education. The Draft Audit Report presents no finding or allegation to the contrary; nor does it assert any instance where the audit fieldwork revealed that funds were misapplied or unaccounted for. Even though the OIG has pointed to no actual or presumptive harm suffered by ED or by any student, the Draft Report recommends that the University repay all the funds – including principal loan amounts already slated for repayment by the students themselves – that were long since spent to educate these students. The OIG can point to no statute, regulation, or principle of law to substantiate the disallowance sought. The OIG has not even explained why the University should repay funds that were duly applied to their lawful intended purposes, or explained why the University should repay loan principal amounts that the students themselves will repay.

3. Nowhere does the Draft Audit Report allege or imply that any SGAS student lacked federal student financial aid eligibility, based upon alleged noncompliance with the Incentive Compensation Rule or with any other Title IV requirement. The Department's student eligibility rules do not include the Incentive Compensation Rule as a student eligibility requirement. Accordingly, no basis exists for the OIG to seek or recommend wholesale disallowance of all federal student financial aid funds received by all SGAS students.

4. Nowhere does the Draft Audit Report allege or imply that any SGAS program lacked federal student financial aid eligibility, based upon alleged noncompliance with the Incentive Compensation Rule or with any other Title IV requirement. The Department's program eligibility rules do not include the Incentive Compensation Rule as a program eligibility requirement. Accordingly, no basis exists for the OIG to seek or recommend wholesale disallowance of all Title IV funds received by all SGAS students.

5. The elements of institutional eligibility set forth in Title IV and ED's regulations do not include the Incentive Compensation Rule as an institutional eligibility requirement. Although Title IV formerly included a different eligibility provision prohibiting the use of commissioned salespersons to promote the availability of federal loans, Congress repealed that provision when it enacted the Incentive Compensation Rule. In fact, prior to enactment of the Rule, the Senate rejected a proposal that would have made the Rule a component of the definition of an eligible institution of higher education. Accordingly, no basis exists for the OIG to seek or recommend wholesale disallowance of all federal student financial aid funds received by all SGAS students.

6. The Draft Audit Report quotes Title IV provisions and ED rules that identify the Incentive Compensation Rule as the twentieth of twenty-six mandatory terms to be included in the

institutional Program Participation Agreement ("PPA") with the Department. However, the PPA terms collectively encompass hundreds of statutory and regulatory requirements prescribed under Title IV of the Higher Education Act. No basis exists to support the OIG's position that an alleged violation of any of these innumerable PPA requirements warrants a wholesale disallowance of all Title IV funds where no statutory or regulatory element of institutional, student, or program eligibility is at issue. The Draft Audit Report does not identify any basis for such an extreme sanction, and various ED administrative decisions support the view that the recommended sanction is both unreasonable and unwarranted. More specifically, the seventeenth PPA term requires institutions to "complete, in a timely manner and to the satisfaction of the Secretary, surveys conducted as part of the Integrated Postsecondary Education Data System." See 34 C.F.R.§ 668.14(b). The OIG's position would require a total disallowance of all Title IV funds for a violation of that ministerial requirement. If however, the OIG's position differs regarding that PPA requirement from its position in this case, the OIG is assigning varying degrees of significance to the PPA requirements, thereby modifying a regulatory scheme without notice-and-comment as required by law.

7. Given the absence of any factual allegations of actual harm, coupled with the absence of any basis for asserting that the University, its students, or its SGAS programs were ineligible for Title IV funds, it would appear that the OIG seeks to impose a wholesale disallowance to punish the University for purported noncompliance. The OIG cannot lawfully seek or recommend punishment in an audit report.

8. The Draft Audit Report incorrectly and drastically overstates the amount of purported liabilities arising out of SGAS students' participation in the Title IV programs by erroneously recommending that the University be required to repurchase all Stafford and PLUS loans disbursed to such students. The Draft Report inexplicably ignores established rules limiting the scope and quantity of any audit disallowances to the ED's actual losses. The Department's established policies and administrative precedent require the application of an actual loss formula that takes into account institutional default rates in lieu of repurchase of all loans. In recommending repurchase of the face amount of these loans, the Draft Audit Report simply ignores the actual loss formula.

Even without the benefit of an OIG explanation seeking to justify the recommended wholesale disallowance, the foregoing preliminary responses establish that the Draft Audit Report's recommendation is unreasonable, unwarranted and arbitrary. The OIG should therefore remove the recommendation from any final report.

III. RESPONSE TO THE DRAFT REPORT'S ASSERTIONS WITH RESPECT TO IPD'S INTERNAL SALARY STRUCTURE.

The Draft Audit Report further questions whether IPD's internal compensation plans were consistent with the Incentive Compensation Rule. The University is, however, unable to itself provide a specific response to the OIG's claim because the contract with IPD specified respective areas of responsibility. The University was responsible for maintaining the academic records of SGAS students, making final determinations on SGAS admissions, and establishing tuition and fees for program. See IPD Contract, pages 13-15. The University also exercised exclusive jurisdiction over curricula content and approval, and was required to hire and pay instructional personnel for the SGAS programs. Id. at page 16. Included among the costs for which IPD was exclusively responsible was "IPD staff payroll." Id. at page 22. IPD also agreed to assist the University with compliance with legal requirements. Id. at page 7.

Because the subject of IPD's internal compensation structure is within the exclusive domain of IPD, and not within the control of the University, we asked IPD to prepare a statement for inclusion in this submission. IPD presented us with the following statement, which is included in its entirety as follows:

* * *

IPD Recruiter Salaries Do Not Violate The Incentive Compensation Rule.

The Draft Report asserts at page 3 that IPD compensation plans "provided incentives to its recruiters through salary levels that were based on the number of students recruited and enrolled in programs." Yet, in describing the IPD salary plan, the Draft Report states "IPD assigned recruiters a salary within the parameters of performance guidelines (i.e., knowledge of basic policies and procedures, organization and communication skills, and working relationships)." The guidelines cited by the OIG are not related to a recruiter's success in securing enrollments – e.g., a recruiter may exhibit any or all of the aforementioned qualities without recruiting a threshold number of students. Thus, the Draft Report itself establishes that the cited IPD compensation plans based recruiter salaries in part on factors that are not based on success in securing enrollments.

To the extent that the Draft Report suggests that provisions for recruiter salaries under IPD compensation plans violate the Incentive Compensation Rule, that contention is incorrect and contrary to law. As detailed below, the cited provisions regarding recruiter salaries are fully consistent with the governing statute and regulation for each of the following reasons.

1. The Incentive Compensation Rule Does Not Prohibit Salary Based On Success In Securing Enrollments.

The terms of the Incentive Compensation Rule do not extend to "salary." Both the governing statute and regulation require a Title IV participating institution to agree that it will not provide:

> [A]ny commission, bonus or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to any persons . . . engaged in any student recruiting or admissions activities.

20 U.S.C. § 1094(a)(20); 34 C.F.R. § 668.14(a)(22). Neither the statute nor the regulation makes reference to salary. The Incentive Compensation Rule only extends to certain "commission[s]," "bonus[es]," or "other incentive payment[s]," each of which are distinct from salary. Accordingly, the express language and plain meaning of the Incentive Compensation Rule signifies that these provisions do not prohibit an institution from basing recruiter salaries, in whole or in part, on success in securing enrollments.

2. The Legislative History of the Incentive Compensation Rule Makes Clear That Congress Intended To Permit Recruiter Salaries To Be Based On Merit.

Even if one erroneously presumed that the Incentive Compensation Rule could extend to certain recruiter "salaries," Congress made clear in enacting the 1992 amendments to the HEA that salary based on success in securing enrollments is not prohibited so long as it is not based solely on success in securing enrollments. Specifically, the Conference Committee that resolved the House and Senate differences in the 1992 HEA Amendments stated that the statute does not prohibit salary that is based on merit, even if measured, in part, by success in securing enrollments. The Committee's report states in pertinent part:

> The conferees note that substantial program abuse has occurred in the student aid programs with respect to the use of commissioned sales representatives. Therefore, this legislation will prohibit this use. The conferees wish to clarify, however, that the use of the term "indirectly" does not imply that the schools cannot base employee salaries on merit. It does imply that such compensation cannot solely be a function of the number of students recruited, admitted, enrolled or awarded financial aid.

Conf. Rep. 630, 102d Cong., 2d Sess. at 499 (1992) (emphasis added). As clarified by the Conference Report, the statute was not aimed at merit-based salaries for recruiters. The Committee instead stated that the Incentive Compensation Rule does not prohibit salary that is based on successful job performance, even if that success is measured, in part, by success in

securing enrollments.

Thus, the Legislative History of the Incentive Compensation Rule contradicts any suggestion in the Draft Report that recruiter salary may not be based on merit. As noted above, the Draft Report itself concedes that the cited provisions for recruiter salaries set forth in the IPD compensation plans satisfy these criteria because they base salary on a variety of performance criteria that are not solely related to success in securing enrollment. Accordingly, the Draft Report acknowledges that the cited IPD compensation plans do not set recruiter salaries based solely on enrollments. The cited salary provisions are therefore consistent with both the text and the intent of the Incentive Compensation Rule.

3. The Secretary has not published any interpretation of the Incentive Compensation Rule that would prohibit recruiter salaries based on merit.

The Secretary has not published an interpretation of the Incentive Compensation Rule that explicitly prohibits basing recruiter salaries on success in securing enrollments. Neither the notice of proposed rulemaking nor the preamble to the final regulations address the issue of "salary" based on success in securing enrollments. 59 Fed. Reg. 22348 (Apr. 29, 1994); 59 Fed. Reg. 9526 (Feb. 28, 1994). Although the Secretary indicated that he might, at some point, publicly clarify what he considers acceptable under the statute and regulation (see 59 Fed.Reg. at 9539), he has not, as of yet, done so. Accordingly, the Secretary has not published any explicit prohibition with respect to recruiter salaries, nor any interpretation contrary to that set forth in the aforementioned Congressional Conference Report.

If the Draft Report is suggesting that the Department prohibits recruiter salaries based in part on enrollments, that suggestion is incorrect, contrary to law, contrary to rational policy, and must be rejected. As detailed above, the Department has not published such an interpretation of the Incentive Compensation Rule. Consequently, there is no basis for the Draft Report's suggestion.

If the Department sought to retroactively enforce the interpretation suggested by the Draft Report, its enforcement would be unlawful because it would contradict both the text of the Incentive Compensation Rule and the intent of Congress. Moreover, the Department has never given institutions advance notice through publication of the interpretation set forth in the Draft Report. An administrative agency must give the regulated public "fair notice" of its regulatory interpretations, or it violates the due process clause of the Fifth Amendment to the U.S. Constitution. Accordingly, the Draft Report's suggested retroactive interpretation of the Incentive Compensation Rule cannot lawfully be enforced.

Moreover, the Draft Report's suggested interpretation with respect to recruiter salaries is premised on an overly broad interpretation of the statute that is contrary to rational policy. The

Draft Report's approach would deprive schools of the ability to appropriately compensate their admissions personnel for what they are employed to do. Specifically, schools would be required in effect to ignore the employee's ability to recruit qualified students who apply for, are accepted, and enroll in school. The aforementioned Conference Report stated explicitly that the Incentive Compensation Rule "does not imply that the schools cannot base employee salaries on merit." Conf. Rep. 630, 102d Cong., 2d Sess. at 499 (1992). In short, the Draft Report's interpretation is contrary to the Incentive Compensation Rule, its history, and rational policy, and must be rejected.

* * *

This concludes the statement supplied by IPD with respect to the portion of the Draft Audit Report focusing upon IPD's internal compensation structure.

CONCLUSION

For all of these reasons, Olivet Nazarene University disagrees with the preliminary findings and recommendations set forth in the Draft Audit Report, and we urge the Office of Inspector General to close the audit. We reserve the right and opportunity to respond further to any final report as may be issued.

Respectfully submitted,

OLIVET NAZARENE UNIVERSITY
Dr. John C. Bowling, President

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