



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

AUDIT SERVICES

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James W. Runcie
Chief Operating Officer
Federal Student Aid
U.S. Department of Education
830 First St., N.E.
Washington, DC 20202

Dear Mr. Runcie:

This final audit report, “Federal Student Aid’s Oversight of Schools’ Compliance with the Incentive Compensation Ban,” presents the results of our audit. The objectives of our audit were to determine whether the office of Federal Student Aid (FSA) of the U.S. Department of Education (Department) (1) sufficiently revised its enforcement procedures and guidance so that they facilitated and did not hinder enforcement actions, (2) adapted and followed its methods to track monitoring activities related to incentive compensation and to detect incentive compensation ban violations, and (3) properly resolved incentive compensation ban findings. We initially planned to also determine whether a sample of schools were in compliance with the regulations governing incentive compensation. However, we dropped this planned objective because it was not directly related to the Department’s oversight of schools’ compliance with the incentive compensation ban. We evaluated the Department’s operations as of June 25, 2014.

We concluded that FSA did not revise its enforcement procedures and guidance to ensure that they facilitated and did not hinder enforcement actions after the Department eliminated the incentive compensation safe harbors in 2010. FSA did not develop procedures and guidance instructing employees on how they should determine the appropriate enforcement action for incentive compensation violations. In addition, an internal memorandum, dated October 30, 2002, from the then Deputy Secretary of Education to the Chief Operating Officer for FSA (Hansen Memo) and the internal procedures and guidance that FSA did develop and implement discouraged FSA employees from using all allowable enforcement actions at FSA’s disposal. As a result, except for one action based in part on incentive compensation, fines were the only enforcement action that FSA used to punish violators of the incentive compensation ban. Without strong procedures and guidance, FSA cannot ensure appropriate and consistent enforcement actions against schools that violate the incentive compensation ban, and fines will likely continue to be the predominant enforcement action that FSA uses to punish violators of the incentive compensation ban.

We concluded that FSA adapted and was following its methods for tracking activities related to incentive compensation and adapted its methods for detecting incentive compensation ban violations. However, we reviewed a judgmentally selected sample of 26 FSA program review files and found that 23 of the files contained insufficient evidence to show that institutional review specialists completed all the incentive compensation testing procedures required by FSA's program review manual.¹ When we discussed incentive compensation testing procedures with the institutional review specialists who conducted 23 of the 26 program reviews, the institutional review specialists responsible for 13 of the 23 program reviews confirmed that they did not always complete all of the incentive compensation testing procedures included in FSA's program review manual. When institutional review specialists do not complete all the incentive compensation testing procedures required by the program review manual, FSA cannot make an informed decision about a school's compliance with the incentive compensation regulations and is less likely to detect incentive compensation violations.

Finally, we found that FSA did not properly resolve incentive compensation ban findings. Institutional review specialists and audit resolution specialists did not consult with FSA's Administrative Actions and Appeals Service Group (AAASG) regarding final actions to be initiated to resolve the one program review and four independent public accountant (IPA) audits that identified violations of the incentive compensation ban from July 1, 2011, through September 17, 2013.² Additionally, audit resolution specialists did not determine the merits of each violation by using a preliminary audit determination letter for findings in the four IPA audit reports. When institutional review specialists and audit resolution specialists do not follow procedures, FSA cannot appropriately (1) determine the extent of each incentive compensation violation, (2) ensure that adequate corrective actions were taken, or (3) ensure that it took enforcement action sufficient to mitigate the risk of future incentive compensation violations.

We provided the draft of this report to FSA for comment. FSA provided general comments along with comments on and proposed actions to address all nine draft audit report recommendations. FSA neither explicitly agreed nor disagreed with Finding No. 1, but it partially agreed with two of the three recommendations. Indicating that the processes and practices already exist, FSA disagreed with the recommendation to develop incentive compensation enforcement procedures and guidance to ensure that FSA effectively makes use of all enforcement actions available under the HEA. Although it partially agreed with two recommendations and disagreed with one, FSA agreed to take actions that, if implemented, should be responsive to all three of the recommendations. FSA agreed to ask the Deputy Secretary of Education to rescind the Hansen Memo. FSA also agreed to document current enforcement action processes and practices and make changes, as needed, to clarify existing guidance on applying the various types of enforcement actions and determining fine amounts for schools that violate the incentive compensation ban.

FSA neither explicitly agreed nor disagreed with Finding No. 2 and Finding No. 3. However, it agreed with all four recommendations associated with Finding No. 2 and both recommendations associated with Finding No. 3. FSA stated that the quality control process

¹ Because we judgmentally selected these 26 program reviews, our results might not be representative of the population and cannot be projected to the program reviews that we did not review.

² The term "audit resolution specialist" applies to any school participation division member who resolves compliance audits conducted by an IPA or the Office of Inspector General. That team member's official title will generally be "institutional review specialist."

it implemented in fiscal year 2014 identified needs for improvement and training to ensure that its employees follow program review procedures, including procedures specific to incentive compensation. Accordingly, FSA agreed to provide refresher training to audit resolution specialists on using preliminary audit determination letters and on consulting with AAASG regarding potential enforcement actions to be initiated. We included FSA's comments on the draft audit report in their entirety as [Attachment 2](#) to this final audit report.

We considered FSA's comments and its proposed corrective actions and concluded that the proposed actions, if implemented, should be sufficient to address all nine recommendations included in this report. Where appropriate, we clarified the report. In the Background section, we clarified how FSA tracks the results of program reviews and IPA audits. In Finding No. 1, we clarified that FSA employees were hesitant to take enforcement actions against schools that might have violated the incentive compensation ban. We also revised Finding No. 3 to more clearly state that we based our conclusions on a review of all four IPA audit reports and the related management responses.

BACKGROUND

In response to substantial abuse of the student financial assistance programs authorized under Title IV of the Higher Education Act of 1965, as amended (Title IV), by schools' using commissioned sales representatives, Congress added section 487(a)(20) to the Higher Education Act of 1965, as amended (HEA), in 1992 to ban schools from providing "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. . . ." Title 34 Code of Federal Regulations (C.F.R.) Section (§) 668.14(b)(22) incorporated the HEA's incentive compensation ban as of July 1, 1994.³ In issuing interim final regulations, the Department took a hardline stance against incentive compensation. According to the Interim Final Regulations (59 FR 22348-01, April 29, 1994)—

The Secretary believes that even in incentive payment structures based on retention there is room for abuse and, in fact, has seen evidence of such abuse. Since July of 1992 when the Amendments of 1992 were enacted, many institutions have opted to change to retention-based pay for admissions personnel. In that time, the Secretary has seen evidence of lowered satisfactory progress standards and in extreme cases, falsified attendance and leave of absence requests, all in an effort to keep students enrolled. In many cases, these practices were designed by admissions personnel who were duly paid after the student passed a retention mark. After that mark, the students were dropped. Furthermore, the Secretary has evidence that some of these students were admitted using falsified ability-to-benefit tests, which further ties the issue of retention to enrollment. The Secretary believes that reputable and conscientious institutions can

³ Unless otherwise noted, all regulatory citations are to the July 1, 2011, volume.

develop other creative ways to reward their employees that will have no direct or indirect relationship to success in securing enrollments.⁴

However, effective July 1, 2003, the Department relaxed its stance on incentive compensation and created 12 safe harbors (34 C.F.R. § 668.14(b)(22)(ii)). Under these regulatory safe harbors, the Department would not consider a school's compensation practices as violating the statutory prohibition on incentive compensation if the school's compensation practices qualified for 1 of the 12 safe harbors. Under the first safe harbor, a school could compensate its employees based on success in securing enrollment or awarding financial aid as long as adjustments were not made more than twice in a calendar year and were not based solely on success in securing enrollments or the awarding of financial aid. The remaining 11 safe harbors described the conditions under which a school could make an incentive payment, to an individual or entity, that otherwise would be considered by the Department as based on success in securing enrollment or awarding financial aid.

In 2010, the Department proposed eliminating the safe harbors. According to the preamble of its October 29, 2010, final regulations, the Department stated that

[U]nscrupulous actors routinely rel[ied] upon these safe harbors to circumvent the intent of section 487(a)(20) of the HEA. As such, rather than serving to effectuate the goals intended by Congress through its adoption of section 487(a)(20) of the HEA, the safe harbors have served to obstruct those objectives and have hampered the Department's ability to efficiently and effectively administer the title IV, HEA programs.

The Department further stated "that students [were] frequently the victims of compensation plans that institutions had adopted within the ambit of the first safe harbor." Final regulations published on October 29, 2010, eliminated the safe harbors, effective July 1, 2011, and clarified that commissions, bonuses, and other incentive payments cannot be directly or indirectly based, in any part, on success in securing enrollments or awarding financial aid.

FSA's Role in Overseeing Schools' Compliance with the Incentive Compensation Ban

Within FSA, Program Compliance was responsible for tracking and analyzing school participation data, monitoring institutional compliance with Title IV requirements, and resolving findings in which schools have violated the incentive compensation regulations. Program Compliance's School Eligibility Service Group was responsible for overseeing and monitoring schools participating in the Title IV programs. The School Eligibility Service Group was divided into eight school participation divisions: seven for domestic schools and one for foreign schools. Each school participation division had employees who specialized in one or more oversight activities. Institutional review specialists conducted program reviews to evaluate a school's compliance with the HEA and Title IV regulations, including the incentive compensation ban. Audit resolution specialists analyzed audit reports prepared by IPAs to determine whether the IPAs identified any condition, including incentive compensation ban violations, that impacted the Title IV programs. Institutional review specialists and

⁴ If a student who first enrolled in a program of study before July 1, 2012, did not have a high school diploma or a recognized equivalent and did not complete secondary school in a homeschool setting, the student had to pass an approved ability-to-benefit test to be eligible for Title IV funds. The Consolidated Appropriations Act, 2012 (Public Law 112-74), eliminated the ability-to-benefit option for students who first enrolled in a program of study on or after July 1, 2012.

audit resolution specialists also resolved incentive compensation ban violations identified through FSA

Program Reviews

To help school participation divisions prioritize the selection of schools for program review, the School Eligibility Service Group analyzed data available in the Postsecondary Education Participants System (PEPS) and other Department information systems. The analyses focused on broad indicators, such as an increase in Title IV funds, whether a school was new, and a school's cohort default rates. None of the indicators were directly related to incentive compensation. School participation divisions used the analyses provided by the School Eligibility Service Group to select schools for program review. However, the school participation divisions also considered other information, such as complaints by students or school employees, stories in the media, and referrals from accrediting agencies or State licensing agencies, when selecting schools for program review.

Once a school participation division decided to conduct a program review, FSA's procedures required it to determine the type of review to be conducted and to document the type and scope of review in a program review work plan. Incentive compensation testing was included in the scope of review for three of the five types of program reviews that FSA conducted.

Institutional review specialists reviewed domestic and foreign schools' compliance with Title IV requirements using a program review manual. FSA required institutional review specialists to complete general incentive compensation testing procedures, which included reviewing the school's policies and procedures and interviewing school employees regarding any compensation or incentive programs. FSA also required institutional review specialists to document the results of their reviews on worksheets. Depending on the type of program review being conducted and any potential deficiencies identified through general testing procedures, FSA also required institutional review specialists to complete detailed testing procedures. According to FSA's program review manual, detailed incentive compensation testing procedures included reviewing payroll history and personnel files for a sample of the school's recruitment employees. FSA's program review manual also included procedures for institutional review specialists to follow when resolving findings, including incentive compensation findings, identified through program reviews.

Program Compliance's Performance Improvement and Procedure Services Group revised FSA's program review manual to incorporate procedures to detect violations of the Title IV regulations that became effective July 1, 2011.⁵ The revised program review manual provided additional guidance for institutional review specialists to consider when performing procedures to detect incentive compensation violations. The additional guidance included information on specific activities that are subject to the incentive compensation ban and information regarding the types of payments that are and are not considered direct or indirect payments of incentive compensation.

⁵ We reviewed two versions of FSA's program review manual: one dated May 31, 2011, and the other dated November 2, 2012. We noted very few differences in the procedures relevant to our audit objectives. Therefore, unless otherwise noted, all references to the FSA program review manual are to the version dated November 2, 2012.

IPA Audits

Schools receiving Title IV funds generally must annually submit to the Department audit reports prepared by IPAs. IPAs must conduct these audits using “The Audit Guide for Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers” (SFA Audit Guide) or Office of Management and Budget (OMB) Circular A-133, “Audits of States, Local Governments, and Non-Profit Organizations” and associated compliance supplements. All schools must submit their annual audits directly to the Department through a Web-based, automated system (eZ-Audit). In addition, audits prepared in accordance with OMB Circular A-133 must be submitted to the Federal Audit Clearinghouse.

FSA hired a contractor to operate eZ-Audit. The contractor used eZ-Audit to evaluate the IPA audit reports against criteria established by Program Compliance and to determine which annual audit reports contained findings serious enough to warrant resolution. Program Compliance has determined that all incentive compensation findings are serious enough to automatically warrant resolution.

FSA’s audit resolution specialists resolved IPA audit reports using procedures and guidance from FSA’s compliance audit manual and the compliance audit manual for foreign schools.⁶ The procedures for resolving compliance audit findings at domestic and foreign schools were the same, in all material respects, with one exception. FSA’s compliance audit manual for foreign schools had not been revised since September 15, 2010. Therefore, it did not reflect a new requirement, effective in June 2012, regarding audit resolution specialists’ consulting with the AAASG on incentive compensation violations.

FSA used PEPS to track the results of program reviews and eZ-Audit to track the results of IPA audits. FSA also used PEPS to track all enforcement actions taken as a result of findings identified through program reviews or IPA audits, as well as any appeals of those actions. As of September 30, 2010, PEPS tracked all three types of program reviews that would cover incentive compensation.

The Department delegated to FSA’s AAASG the authority to take enforcement actions against schools that violate Title IV requirements. FSA required AAASG, in consultation with the Office of the General Counsel, to evaluate the merits of each case and determine the final actions to be initiated. Accordingly, FSA required institutional review specialists and audit resolution specialists to consult with AAASG on incentive compensation findings before issuing preliminary program review reports or draft audit determination letters to schools.

GAO Audits of the Department

In 2010, the United States Government Accountability Office (GAO) issued two reports relevant to our audit objectives. In the first, “Higher Education: Information on Incentive Compensation Violations Substantiated by the U.S. Department of Education” (GAO-10-370R, February 2010), GAO reported that it analyzed the Department’s program review and audit report data related to the incentive compensation rules for January 1998 through December 2009. For that period, GAO found that the Department reported incentive compensation violations by 32 schools.

⁶ We reviewed two versions of FSA’s compliance audit manual: one dated September 30, 2010, and the other dated November 2, 2012. We noted very few differences in the procedures relevant to our audit objectives. Therefore, unless otherwise noted, all references to FSA’s compliance audit manual are to the version dated November 2, 2012.

In the second, “Higher Education: Stronger Federal Oversight Needed to Enforce Ban on Incentive Payments to School Recruiters” (GAO-11-10, October 2010), GAO reported that it examined (1) how the Department monitored schools for potential violations of the incentive compensation ban and (2) the extent to which the Department had used its authority to enforce the incentive compensation ban. GAO reported that the Department had processes to monitor schools for potential incentive compensation payment violations, but its methods to detect violations and track monitoring activities were limited.⁷ In addition, GAO reported that the Department had used some of its authority to enforce the incentive compensation ban, but its efforts might have been hindered by its own policies and practices. In response to the second report, the Department acknowledged that the final publication of the incentive compensation regulations in 2010 provided the Department with an excellent opportunity to revise its enforcement policies and practices.

AUDIT RESULTS

The objectives of our audit were to determine whether FSA (1) sufficiently revised its enforcement procedures and guidance so that they facilitated and did not hinder enforcement actions, (2) adapted and followed its methods to track monitoring activities related to incentive compensation and to detect incentive compensation ban violations, and (3) properly resolved incentive compensation ban findings. We evaluated the Department’s operations related to the incentive compensation ban as of June 25, 2014.

We concluded that FSA did not revise its procedures and guidance to ensure that they facilitated and did not hinder enforcement actions. FSA did not develop procedures and guidance that clearly explained how its employees should determine the appropriate enforcement action for incentive compensation violations. In addition, the Hansen Memo and FSA’s internal procedures and guidance discouraged FSA employees from using all allowable enforcement actions at their disposal. As a result, except for one action based in part on incentive compensation, fines were the only enforcement action that FSA used to punish violators of the incentive compensation ban. Without strong procedures and guidance, FSA cannot ensure appropriate and consistent enforcement actions against schools that violate the incentive compensation ban, and fines will likely continue to be the predominant enforcement action that FSA uses to punish violators of the incentive compensation ban.

We concluded that FSA adapted and was following its methods for tracking activities related to incentive compensation, and FSA adapted its methods for detecting incentive compensation ban violations. However, we reviewed a judgmentally selected sample of 26 FSA program review files and found that 23 of the files contained insufficient evidence to show that

⁷ GAO recommended that the Department (1) coordinate with the Office of Inspector General to strengthen suggested procedures provided to IPAs for reviewing schools’ compliance with the incentive compensation ban, (2) separately track program reviews that focused on incentive compensation, and (3) update its guidance used to set fines and settlement payments and apply the guidance when determining financial penalties for incentive compensation violations. As of August 2014, GAO had closed the first two recommendations but the third recommendation remained open.

institutional review specialists completed all the incentive compensation testing procedures that FSA established to detect incentive compensation violations. When institutional review specialists do not complete all the incentive compensation testing procedures required by the program review manual, FSA cannot make an informed decision about a school's compliance with the incentive compensation regulations and is less likely to detect an incentive compensation violation.

Finally, we found that FSA did not properly resolve incentive compensation ban findings. Institutional review specialists and audit resolution specialists did not consult with AAASG regarding final actions to be initiated to resolve the one program review and four IPA audits that identified violations of the incentive compensation ban from July 1, 2011, through September 17, 2013. Additionally, audit resolution specialists did not determine the merits of each violation by using a preliminary audit determination letter for findings in the four IPA audit reports. When institutional review specialists and audit resolution specialists do not follow procedures for resolving incentive compensation ban violations, FSA cannot appropriately (1) determine the extent of each incentive compensation violation, (2) ensure that adequate corrective actions were taken, or (3) ensure that it took enforcement action sufficient to mitigate the risk of future incentive compensation violations.

FSA Comments

FSA stated that it agreed that compliance with the incentive compensation ban is an important component of schools' compliance with Title IV requirements but its enforcement practices at the time of our audit were in accordance with required Department policy and procedures. FSA also stated that the Department's efforts to strengthen enforcement of the incentive compensation ban have been challenged in the courts in recent years, so it needs to work closely with legal counsel on decisions involving incentive compensation ban violations and related policy and procedural matters.

Despite the potential impact of recent legal challenges, FSA agreed to document current enforcement action processes and practices and make changes, as needed, to clarify existing guidance on applying the various types of enforcement actions and determining fine amounts for schools that violate the incentive compensation ban. FSA further stated that the quality control process it implemented in fiscal year 2014 identified needs for improvement and training to ensure that its employees follow program review procedures, including procedures specific to incentive compensation. Accordingly, FSA agreed to provide refresher training to audit resolution specialists on using preliminary audit determination letters and on consulting with AAASG regarding potential enforcement actions to be initiated.

FINDING NO. 1 – Enforcement Policies and Procedures Not Sufficient to Ensure Appropriate and Consistent Actions Against Schools That Violate the Incentive Compensation Ban

FSA did not ensure appropriate and consistent enforcement actions against schools that violated the incentive compensation ban. Because FSA had not developed procedures and guidance explaining when and how to apply all of the various types of enforcement actions available when schools violated the incentive compensation ban, fines were the predominant enforcement action that FSA used to punish violators of the incentive compensation ban. The procedures and

guidance that FSA used to initiate fines did not clearly describe how FSA employees should determine the amount of a fine resulting from an incentive compensation violation.

Effective Procedures and Guidance on Enforcement Actions Not Developed and Employed

FSA created procedures for imposing fines against schools but did not provide guidance explaining when and how to apply the other types of enforcement actions available under the HEA and Title IV regulations. The HEA and Title IV regulations provide for enforcement actions against schools that violate the incentive compensation ban, including emergency actions to withhold Title IV funds and the limitation, suspension, or termination of the school's participation in the Title IV programs. FSA may take the following actions against schools that violate their obligations under the HEA:

- An emergency action that could include withholding Title IV funds from the school or its students or withdrawing the authority of the school to obligate Title IV funds (section 487(c)(1)(G) of the HEA and 34 C.F.R. § 668.83).
- The imposition of a fine up to \$35,000 per violation on a participating school (sections 487(c)(1)(F) and 487(c)(3)(B)(i) of the HEA and 34 C.F.R. § 668.84).
- The limitation, suspension, or termination of the participation of the school in a Title IV program (section 487(c)(1)(F) of the HEA and 34 C.F.R. §§ 668.85 and 668.86).
- Revocation of a school's provisional program participation agreement (section 498(h)(3) of the HEA and 34 C.F.R. § 668.13(d)(1)) or denial of a pending application for recertification (section 498(g) of the HEA and 34 C.F.R. § 668.13(a)).

According to an AAASG special assistant, FSA has not limited, suspended, or terminated any schools' participation in the Title IV programs when those schools violated the incentive compensation ban. In addition, FSA provided us with only one example of when it revoked a school's provisional program participation agreement based, in part, on an incentive compensation violation. FSA revoked the school's provisional program participation agreement on August 31, 2009.

The Hansen Memo stated that the appropriate enforcement action for an incentive compensation violation would generally be a fine. Department employees were generally to treat an incentive compensation violation "as a compliance matter for which remedial or punitive sanctions should be considered." Therefore, incentive compensation violations "may constitute a basis for limitation, suspension, or termination action. However, much more commonly, the appropriate sanction to consider will be the imposition of a fine." FSA's own guidance to its employees further encouraged the use of fines for schools that violated the incentive compensation ban. According to an email from a Performance Improvement and Procedure Services Group program review liaison, institutional review specialists and audit resolution specialists must consult with AAASG on incentive compensation violations so that AAASG can make a preliminary determination regarding a possible fine. The email did not mention the possibility of any enforcement actions other than fines.

According to the Chief Compliance Officer for FSA, FSA's enforcement of the incentive compensation ban was guided by the Hansen Memo. The Chief Compliance Officer for FSA and the director of AAASG also stated that they were required to follow the Hansen Memo when determining the appropriate enforcement action for an incentive compensation violation. The Chief Compliance Officer for FSA further stated that FSA's predominant use of fines as enforcement actions against schools that violate the incentive compensation ban was in accordance with the guidance set forth in the Hansen Memo.

In an October 2010 report, GAO reported that, before the Hansen Memo, FSA had generally assessed liabilities for incentive compensation violations as opposed to assessing fines. GAO stressed that two weaknesses resulted from the move from assessing liabilities to using fines. First, fines are often significantly smaller dollar amounts than liabilities, which require a school to pay back Title IV funds related to a violation. Second, when assessing a fine, the Department must prove that the school did not comply with the incentive compensation regulations. In contrast, when the Department identifies a liability or an instance of noncompliance, the school must prove that it complied with the incentive compensation regulations.

Guidance on Fine Determinations Not Clear

According to the Department's Administrative Communications System Directive, "Records and Information Management Program," OM: 6-103, August 7, 2012, the Department must create and maintain official records to document all of its policies and procedures.

To determine the appropriate fine for an incentive compensation violation, FSA considered (1) guidance provided in the Hansen Memo, (2) a general fine guidance document developed by FSA that was not specific to incentive compensation, and (3) previous fine amounts imposed on schools that violated the incentive compensation regulation. However, the guidance did not clearly describe how FSA employees should determine the amount of a fine resulting from an incentive compensation violation.

The Hansen Memo and FSA's general fine guidance described aggravating and mitigating circumstances that FSA employees were to consider when determining the amount of a fine. The general fine guidance document also described four categories of violations that should be used to determine fine amounts. According to the director of AAASG, the total fine amount for incentive compensation findings was not limited. However, we found that FSA's guidance did not clearly describe how the number of incentive compensation violation occurrences should be determined or whether incentive compensation violations should result in a single institutional fine or a larger fine based on multiple incentive compensation violation occurrences.

In 2010, GAO reported the same issue concerning the use of appropriate and consistent fines and sanctions for schools that violated the incentive compensation ban. GAO recommended that the Department update its guidance used to set fines and settlement payments. GAO further recommended that the Department apply the guidance when determining fines and settlement payments for incentive compensation cases. In its response to the GAO report, FSA stated that the elimination of the safe harbors from the incentive compensation regulations, effective July 1, 2011, would allow FSA to reevaluate its guidance for the appropriate sanction when there is an incentive compensation violation. More than 3 years later, FSA had not revised its guidance to explain when to apply the various types of enforcement actions available. As of

August 2014, GAO had not closed this recommendation because FSA had not established a process to weigh factors in an incentive compensation case that affect final fines and settlement payments, such as how an incident of incentive compensation should be defined.

Consistent with their fiduciary obligations, all schools participating in the Title IV programs are expected to demonstrate compliance with all Title IV requirements. The Hansen Memo and FSA's internal procedures and guidance discouraged FSA employees from using all allowable enforcement actions at FSA's disposal. As a result, FSA employees were hesitant to take enforcement actions against schools that might have violated the incentive compensation ban. In cases of particularly egregious violations, fines would not be an appropriate deterrent to future violations. Fines are often significantly smaller dollar amounts than liabilities, which require a school to pay back Title IV funds related to each violation of a compliance requirement. Excepting incentive compensation compliance from a school's fiduciary obligation significantly restricts the ability of the Department to protect students from unscrupulous actors that the Department found used the prior safe harbors to circumvent the HEA's incentive compensation ban.

Recommendations

We recommend that the Chief Operating Officer for FSA—

- 1.1 Request that the Deputy Secretary of Education rescind the Hansen Memo and have FSA develop incentive compensation enforcement procedures and guidance that effectively make use of all enforcement actions available under the HEA.
- 1.2 Develop written procedures and guidance explaining when to apply the various types of enforcement actions (sections 487 and 498 of the HEA and 34 C.F.R. Part 668) against schools that violate the incentive compensation ban.
- 1.3 Clarify existing guidance for determining fine amounts for schools that violate the incentive compensation ban. At a minimum, clarification should cover how the number of incentive compensation violation occurrences should be determined and whether incentive compensation violations should result in a single institutional fine or a larger fine based on multiple incentive compensation violation occurrences.

FSA Comments

FSA agreed to ask the Deputy Secretary of Education to rescind the Hansen Memo. FSA also agreed to clarify existing guidance for determining fine amounts for schools that violate the incentive compensation ban.

FSA disagreed that it needed to develop incentive compensation enforcement procedures and guidance to ensure that it effectively makes use of all enforcement actions available under the HEA. FSA also disagreed that it needed to develop written procedures and guidance explaining when and how to apply the various types of enforcement actions. FSA stated that it did not need to tell FSA employees how to determine appropriate enforcement actions because only the director of AAASG, in consultation with the Office of General Counsel, determines enforcement actions. FSA also stated that such processes and practices already exist. The enforcement actions available to AAASG when schools violate the incentive compensation ban are not any

different from those available for any violation of the statutes and regulations governing the Title IV programs.

Finally, FSA disagreed that its fine guidance needed to clarify how the number of incentive compensation violation occurrences should be determined and whether incentive compensation violations should result in a single institutional fine or a larger fine based on multiple incentive compensation violation occurrences. FSA stated that fine guidance must be general to be useful and universally applicable, and the current fine guidance is sufficiently detailed for the AAASG and the Office of General Counsel employees who work on incentive compensation issues and violations.

Office of Inspector General Response

Although FSA partially disagreed with Recommendations 1.1 and 1.3 and disagreed with Recommendation 1.2, it proposed corrective actions that, if implemented, should be sufficient to address all three recommendations.

We understand that AAASG, in consultation with the Office of General Counsel, evaluates the merits of each case and determines final enforcement actions to be initiated. However, institutional review specialists, audit resolution specialists, compliance managers, and school participation division directors are responsible for bringing violations of the incentive compensation ban to the attention of AAASG before issuing a preliminary program review report or draft audit determination letter. If FSA employees other than those working in AAASG are not aware of the appropriate procedures and available enforcement actions, they might not discuss potential violations of the incentive compensation ban with the appropriate AAASG officials, and no enforcement actions will be taken. Additionally, although AAASG's current officials are knowledgeable about the undocumented processes and practices for enforcing the incentive compensation ban, FSA has an opportunity while those officials are still working to ensure that their successors will have the information needed to make well-informed, appropriate enforcement action decisions.

As established in the draft of this report and FSA's comments on the draft report, the Hansen Memo set forth the Department's preferred method of enforcing the incentive compensation ban and has dominated FSA's incentive compensation enforcement actions since 2002. If the Department rescinds the memo, FSA will need documented guidance on when and how to apply all available enforcement actions. Given the new regulatory landscape, FSA has an opportunity to review its enforcement policies and procedures and set new expectations of enforcement for the incentive compensation ban.

FINDING NO. 2 – Procedures for Detecting Incentive Compensation Ban Violations Were Insufficient and Not Always Followed

We found that FSA's program review manual did not include procedures for evaluating a school's compensation policies and practices for personnel or entities engaged in awarding Title IV funds. The procedures required evaluating a school's compensation policies and practices only for all persons or entities engaged in any student recruiting or admitting activities for the school.

We also found that institutional review specialists did not always follow the procedures that FSA established to detect incentive compensation ban violations. We reviewed a judgmentally selected sample of 26 program review files and found that 23 files contained insufficient evidence to show that institutional review specialists completed all of the incentive compensation testing procedures required by FSA's program review manual.⁸ As a result, these 23 program reviews were not sufficient to provide FSA with assurances that schools complied with the incentive compensation requirements. When we discussed program review procedures with the institutional review specialists who conducted 23 of the 26 reviews, the institutional review specialists responsible for 13 of the 23 program reviews confirmed that they did not always complete all required incentive compensation testing procedures.

Finally, we found that the files for six program reviews included indicators that incentive compensation might have been paid. However, the institutional review specialists who conducted these six program reviews did not perform additional testing procedures to determine whether the school paid incentive compensation.

Insufficient Testing Procedures

FSA's program review manual did not include procedures for evaluating a school's compensation policies and practices for personnel or entities engaged in making decisions about awarding Title IV funds. The incentive compensation ban applies equally to personnel and entities engaged in student recruiting and admitting activities and those engaged in making decisions about awarding Title IV funds. However, FSA's program review manual did not include procedures to obtain and review a school's compensation policies and procedures or incentive programs for employees or entities engaged in making decisions about awarding Title IV funds. In addition, the program review manual did not include procedures for institutional review specialists to interview school employees or representatives of entities making decisions about awarding Title IV funds. Finally, the program review manual did not include procedures for institutional review specialists to review payroll history and personnel files for employees engaged in making decisions about awarding Title IV funds.

When FSA does not design testing procedures sufficient to detect incentive compensation violations, it does not have assurances that its institutional review specialists will identify violations of the incentive compensation regulations.

FSA's Program Review Manual Required the Completion of Certain Incentive Compensation Testing Procedures

According to FSA's program review manual, the lead institutional review specialist was responsible for maintaining documentation to support the work performed and the findings of the program review. The program review manual described the incentive compensation testing procedures required for each of the various types of reviews that FSA conducted. Depending on the type of review being conducted, the program review manual required institutional review specialists to perform general testing procedures or detailed testing procedures. FSA's program review manual also required institutional review specialists to perform detailed testing procedures when general testing procedures identified potential violations of the incentive

⁸ Our universe included 253 program reviews that were started from July 1, 2011, through September 17, 2013; included the review of at least 1 award year that began July 1, 2011, or later; included incentive compensation in the scope of review; and had a program review report issued as of December 17, 2013.

compensation regulations. The program review manual required institutional review specialists to document the results of their reviews on worksheets.

Insufficient Evidence to Support Completion of Required Incentive Compensation Testing Procedures

FSA required institutional review specialists to perform the general testing procedures for all 26 program reviews in our sample. Required general testing procedures included reviewing the school's policies and procedures regarding any compensation or incentive programs of all persons or entities engaged in any student recruitment or admissions activities for the school. FSA also required institutional review specialists to interview school employees engaged in student recruitment or admissions activities.

For the 26 program review files that we reviewed, we found that

- 20 program review files did not contain evidence that the institutional review specialists reviewed the school's policies and procedures, and
- 18 program review files did not contain evidence that the institutional review specialists interviewed the required number of school employees.

Institutional review specialists were required to document the results of their general testing procedures in the Incentive Compensation Worksheet for only 20 of the 26 program reviews in our sample.⁹ Of the 20 program review files that required the institutional review specialists to document the results of their general testing procedures in the Incentive Compensation Worksheet, 6 did not contain evidence that the institutional review specialists completed the Incentive Compensation Worksheet.¹⁰

Only one program review in our sample was the type of review that required detailed testing procedures. Required detailed testing procedures included reviewing payroll history and personnel files for the past 2 calendar years for a sample of at least 25 percent of the school's recruitment employees. We found that this one program review file did not contain any evidence that the institutional review specialist reviewed payroll history. Additionally, although the program review file showed that the institutional review specialist reviewed the personnel records for 20 employees, the file did not contain evidence that the institutional review specialist satisfied the requirement to review payroll history for the past 2 calendar years for at least 25 percent of the recruitment employees.

Table 1 summarizes the number of program reviews with requirements to conduct the different incentive compensation testing procedures and the number of program review files that did not contain evidence to support the completion of the required procedures.

⁹ For six of the program reviews in our sample, the type of program review conducted did not require the institutional review specialists to document their general testing procedures in the Incentive Compensation Worksheet.

¹⁰ In some files, we found insufficient evidence that institutional review specialists completed multiple, required incentive compensation testing procedures. Therefore, the numbers of program review files in each category shown in Table 1 are not mutually exclusive.

Table 1. Sampled Program Reviews’ Adherence to Required Incentive Compensation Testing Procedures

Incentive Compensation Testing Procedure	Level of Incentive Compensation Testing Procedure	Number of Sampled Program Reviews That Required Completion of the Procedure	Number of Sampled Program Review Files That Did Not Contain Evidence to Support Completion of the Procedure	Number of Institutional Review Specialists Who Confirmed That They Did Not Complete the Procedure
Review Policies and Procedures	General	26	20	7
Interview School Employees	General	26	18	9
Complete Incentive Compensation Worksheet	General	20	6	4
Review Payroll History	Detailed	1	1	1
Review Personnel Files	Detailed	1	1	1

Evidence of General Testing Procedures

For general testing, FSA required institutional review specialists to review the school’s policies and procedures regarding incentive compensation, interview school employees, and complete the Incentive Compensation Worksheet.

Review School’s Policies and Procedures

According to FSA’s program review manual, the review of a school’s policies and procedures was to include “written documents, policies or procedures regarding any compensation or incentive programs of all persons or entities engaged in any student recruiting or admission activities for the institution.” The review also was to include “any guidelines for evaluating recruitment staff and [an explanation of] how the recruitment staff receives pay [or] incentive increases.” The school was required to provide to the institutional review specialist a narrative of the school’s practices if it did not have written policies and procedures. After obtaining the required information, FSA required the institutional review specialists to determine whether the information indicated that the school improperly provided performance-based incentives.

Institutional review specialists should have completed a review of the school’s policies and procedures for all 26 program reviews in our sample. However, 20 of the 26 program review files did not contain evidence that institutional review specialists reviewed the school’s policies and procedures regarding any compensation, evaluation, or incentive programs of all persons or entities engaged in any student recruitment or admission activities. The institutional review specialists who conducted seven of these program reviews confirmed that they did not complete this required procedure. Five of the seven institutional review specialists stated that they did not complete this required procedure because the school told them that it did not have any incentive compensation policies.

FSA's program review manual did not limit the review of policies and procedures to a school's incentive compensation policy. FSA also required institutional review specialists to obtain and review a school's policies, procedures, and guidance regarding performance evaluations and available pay increases for all employees who were engaged in recruitment or admissions activities. Based on our review of the 26 program review files and our discussions with institutional review specialists, when schools told the institutional review specialists that the school did not have incentive compensation policies and procedures, the institutional review specialists did not conduct any additional work, such as asking the school to provide a narrative of its practices so that the institutional review specialists could gain an understanding of how recruiters were evaluated and received pay increases.

Interview School Employees

According to FSA's program review manual, interviewing school employees meant that the institutional review specialist was to interview one or two school employees engaged in student recruitment or admission activities. Institutional review specialists should have completed this procedure for all 26 program reviews in our sample. However, 18 of the 26 program review files that we reviewed did not contain evidence that institutional review specialists conducted the required number of interviews. The institutional review specialists who conducted 9 of these 18 program reviews confirmed that they did not complete all of the required interviews. The institutional review specialists who conducted four of the nine program reviews decided not to conduct the required interviews because the school was small, did not employ recruiters, or did not employ people dedicated to recruitment or admissions. Although a school might not employ people dedicated to recruitment and admissions, a school will always have employees responsible for recruiting or admitting students. Institutional review specialists should always ensure that these employees are interviewed before concluding that a school did not violate the incentive compensation regulations.

FSA's program review manual stated that institutional review specialists must obtain an understanding of the school's compensation practices to compare the school's policies and procedures with the school's implementation of those policies and procedures to ensure that the practices complied with the regulations. To obtain a full understanding, FSA required institutional review specialists to determine whether a school provided any incentive, cash or noncash, based on performance. FSA's program review manual provided institutional review specialists with suggested interview questions to use during interviews with school employees in recruitment and admissions roles. The suggestions included detailed questions regarding compensation. Suggested questions included one general question about how the school recruited students and whether the school compensated employees based on success in securing enrollments. FSA's program review manual also included a separate incentive compensation section with suggested questions about salary increases or bonuses, in-kind payments, performance-based contests, job-performance evaluations, enrollment tracking, and gifts. Although suggestions, the answers to such questions would have provided the institutional review specialists with important information that they needed to make an appropriate determination about whether a school was at risk of violating the incentive compensation regulations.

Eleven of the 26 program review files that we reviewed contained documentation of interviews but lacked evidence that the institutional review specialists asked all of the suggested incentive compensation questions. Additionally, we did not find evidence in the program review files that

indicated the institutional review specialists asked other types of questions or performed other procedures to gain a full understanding of the school's compensation policies, procedures, and practices. The institutional review specialists who conducted 10 of these 11 program reviews confirmed that they did not always ask all of the suggested incentive compensation questions. Eight institutional review specialists stated that they asked only the first general question regarding incentive compensation and how employees were paid.

Based on our review of the 26 program review files and our discussions with institutional review specialists, we concluded that when a school's employees told the institutional review specialists that the school did not have any incentive compensation policies or that the school only paid employees a salary, the institutional review specialists did not conduct any additional work. Only four institutional review specialists stated that they would ask the specific incentive compensation questions suggested by FSA's program review manual if they identified a red flag based on how the school's employees answered the general question. Another institutional review specialist told us that if he learned answers to the suggested recruitment and admissions questions while interviewing other groups, he would not ask those questions again during the interviews with recruitment and admissions employees.

Complete the Incentive Compensation Worksheet

Depending on the type of program review being conducted, FSA required institutional review specialists to document the results of their review of policies and procedures and interviews of employees engaged in recruitment or admissions activities in the Incentive Compensation Worksheet. According to FSA's program review manual, work papers demonstrate procedural consistency and support the review work performed. Standardized organization of work papers is beneficial to the program review team, compliance managers, and other Department officials. Given the description in FSA's program review manual, we concluded that, to ensure standardized documentation of incentive compensation testing, institutional review specialists should have completed the Incentive Compensation Worksheet for all program reviews that included incentive compensation in the scope of the review.

Twenty of the 26 program reviews in our sample included incentive compensation in the scope of the review and should have contained a completed Incentive Compensation Worksheet. However, we found that 6 of the 20 program review files did not include a completed Incentive Compensation Worksheet. The institutional review specialists who conducted four of these six program reviews confirmed that they did not complete the Incentive Compensation Worksheet. Two institutional review specialists stated that they complete the worksheet only if they identified an incentive compensation violation; another institutional review specialist stated that he did not complete the worksheet if the school did not have policies on incentive compensation.

Evidence of Detailed Testing Procedures

Depending on the type of program review being conducted and any potential deficiencies identified through general incentive compensation testing procedures, FSA required institutional review specialists to complete detailed testing procedures. According to FSA's program review manual, detailed testing procedures required institutional review specialists to review payroll history and personnel files for a sample of a school's recruitment employees.

Review Payroll History

According to FSA's program review manual, detailed testing procedures require reviewing the payroll history covering the past 2 calendar years for a sample of at least 25 percent of a school's internal and external recruitment staff. To complete this procedure, institutional review specialists were required to obtain an understanding of the basis for any fluctuations in paycheck amounts between pay periods.

Only one program review in our sample was the type of program review that required detailed testing procedures. The file for that one program review did not contain any evidence that the institutional review specialist reviewed the payroll history covering the past 2 calendar years for at least 25 percent of the school's internal and external recruitment staff. The institutional review specialist told us that no issues could be detected through a review of payroll history that could not be detected through a review of personnel files. Relying solely on a review of personnel files could result in institutional review specialists missing indicators of incentive payments that they could have found by thoroughly reviewing payroll history.

Review Personnel Files

The detailed testing procedures in FSA's program review manual also required institutional review specialists to review personnel records covering the past 2 calendar years for a sample of at least 25 percent of a school's internal and external recruitment staff. Institutional review specialists were required to look for information indicating that the recruitment staff were being tracked by their enrollment numbers.

Only one program review in our sample was the type of program review that required detailed testing procedures. The file for that one program review contained evidence that the institutional review specialist reviewed 20 personnel records but did not indicate whether the review of 20 personnel records met the requirement to review personnel records covering the past 2 calendar years for at least 25 percent of the school's internal and external recruitment staff.

According to FSA's program review manual, institutional review specialists should record all issues identified during the reviews of payroll history and personnel files on the Incentive Compensation Expanded Worksheet. The file for the one program review that required detailed testing procedures did not contain a completed Incentive Compensation Expanded Worksheet. Although FSA did not require institutional review specialists to complete the Incentive Compensation Expanded Worksheet when they did not identify any issues, completing the worksheet could have ensured standardized documentation of incentive compensation testing and benefitted the program review team, compliance managers, and other Department officials.

Additional Testing Procedures Not Performed When Indicators of Incentive Compensation Violations Existed

According to FSA's program review manual, "[i]f the reviewer suspects the institution has procedures that would violate the incentive compensation regulations, the reviewer must discuss with his or her Compliance Manager whether or not any additions or adjustments to the work plan need to be made. The program review work plan and interview questions may need to be adjusted accordingly." We determined that the files for six program reviews included indicators that the school might have violated the incentive compensation ban.

As described below, despite evidence in the files, the institutional review specialists who conducted the six program reviews did not complete additional testing procedures to determine whether incentive compensation was paid.

- One school established a compensation plan for admissions representatives, effective July 1, 2011, that created a disincentive for admissions representatives who did not meet minimum performance expectations. The minimum performance expectations were based on success in securing enrollments. The compensation plan established a points system that was based on the number of students the admissions representatives enrolled. If admissions representatives did not meet these quotas, they were required to have an evaluation meeting that could result in the termination of their employment. The compensation plan set salary levels based on an admissions representative's experience but did not indicate how compensation would be affected by the points system. The program review file contained documentation of this compensation plan. However, the file did not contain evidence that the institutional review specialists reviewed these policies and determined whether the policies influenced compensation.
- One school had a profit-sharing plan that was available to the school's president, who was responsible for recruitment. Additionally, the school had a policy to pay \$8 per lead generated. The program review file did not contain evidence that the institutional review specialists obtained and reviewed the profit-sharing plan or the lead generation policies to determine whether the payments were based on success in securing enrollment.
- One school had a profit-sharing plan that was generally available to employees of the company, including those employees involved in recruitment. The program review file did not contain evidence that the institutional review specialists determined whether the plan complied with the incentive compensation requirements.
- One school disclosed a list of third party servicers involved in recruitment and admissions. The program review file did not contain evidence that the institutional review specialists determined whether payments for recruitment and admissions services complied with the incentive compensation requirements.
- One school had a compensation plan in place before July 1, 2011, that clearly provided for incentive payments to employees engaged in recruitment activities. Effective July 1, 2011, the school developed a new performance evaluation for employees engaged in recruitment activities that was supposedly aligned with the new incentive compensation requirements. The program review file did not contain evidence that the institutional review specialists completed procedures to ensure that use of the previous compensation plan had been discontinued, and employees engaged in recruitment activities were no longer being evaluated and paid based on success in securing enrollments.
- One school had a performance plan, effective April 1, 2011, through March 31, 2012, that established a system to evaluate overall performance based, in part, on whether

employees who were engaged in recruitment activities succeeded in securing enrollments. The program review file did not contain evidence that institutional review specialists considered whether the use of performance evaluations based, in part, on success in securing enrollments violated the incentive compensation requirements.

When institutional review specialists do not complete the incentive compensation testing procedures that FSA created to detect incentive compensation violations, they are unlikely to detect incentive compensation violations. In addition, FSA does not have assurances that the institutional review specialists are fully informed before concluding that a school did not violate the incentive compensation ban. If results of program reviews incorrectly suggest that schools are not violating the incentive compensation ban, then FSA has not adequately addressed the risks that incentive compensation poses to students.

Risks to Students

Because of the potential harm to students that could occur if schools violate the ban, incentive compensation is an area that poses significant risk to the Title IV programs and the Department's reputation. The Department acknowledged the significant risk when it proposed eliminating the safe harbors: "[w]hen admissions personnel are compensated substantially, if not entirely, upon the number of students enrolled, the incentive to deceive or misrepresent the manner in which a particular education program meets a student's need increases substantially" (Program Integrity Issues, 75 FR 34806, 34817, June 18, 2010). Incentive compensation violations have been the subject of allegations brought by whistleblowers pursuant to the False Claims Act. Since 2012, our special agents have investigated at least 24 allegations of incentive compensation violations. In addition, at least 15 States Attorneys General have investigated the business practices of for-profit colleges in their States. According to four schools' U.S. Securities and Exchange Commission filings from August 2011 through January 2014, the Attorney General investigations focused on the recruitment of students, lead generation activities, and compensation of admissions representatives, among other matters.

Weaknesses in FSA's System of Internal Control

FSA's system of internal control did not sufficiently mitigate the risks to the Title IV programs posed by incentive compensation. Based on our review of FSA's risk assessment process, the results of our review of 26 program review files, and our interviews with FSA employees, we found that FSA did not, in practice, consider incentive compensation to be a high-risk area. In addition, FSA did not ensure that its employees completed the procedures necessary to detect incentive compensation violations. Specifically, FSA's policies did not require compliance managers to review program review documentation to ensure that all required incentive compensation testing procedures were completed and that appropriate conclusions about a school's compliance with the incentive compensation requirements were reached. When we discussed incentive compensation with compliance managers who supervised 11 of the 26 program reviews in our sample, they stated that they did not review program review documentation related to incentive compensation if there were no incentive compensation findings included in the program review report. In addition, the compliance managers stated that they did not look for or review the Incentive Compensation Worksheet or institutional review specialists' notes on required interviews. As detailed in Finding No. 3, FSA also did not properly resolve incentive compensation violations when one program review and four IPA audits identified violations of the incentive compensation ban.

Recommendations

We recommend that the Chief Operating Officer for FSA—

- 2.1 Require employees to complete all required incentive compensation testing procedures and document all conclusions reached regarding the school's compliance with the incentive compensation regulations.
- 2.2 Stress the importance of institutional review specialists understanding what constitutes an incentive compensation violation and the situations in which they should discuss with their compliance managers whether any additions or adjustments to the program review work plan or interview questions are necessary.
- 2.3 Revise the general and detailed incentive compensation testing procedures in the FSA program review manual to include procedures applicable to personnel and entities engaged in making decisions about awarding Title IV funds.
- 2.4 Require compliance managers to review program review documentation to ensure that institutional review specialists completed all required work, reached appropriate conclusions about a school's compliance with the incentive compensation regulations, and adequately supported their work and conclusions. Compliance managers could sign relevant documentation or employ other methods to note their review.

FSA Comments

FSA agreed with all four recommendations.

FINDING NO. 3 – FSA Did Not Properly Resolve Incentive Compensation Findings Identified in Program Reviews and Audits

FSA did not properly resolve incentive compensation violations when one program review and four IPA audits identified violations of the incentive compensation ban. We found that FSA did not obtain sufficient detail to make an informed decision regarding the enforcement of the incentive compensation ban, and institutional review and audit resolution specialists did not (1) consult with its AAASG regarding final actions to be initiated to resolve the one program review and four IPA audits that identified violations of the incentive compensation ban or (2) determine the merits of each finding in the four IPA audit reports using a preliminary audit determination letter.

According to FSA, from July 1, 2011, through September 17, 2013, one program review and four IPA audits identified incentive compensation violations. The one program review report stated that the school offered a one-time, \$1,000 grant to any student who referred another student who later attended the school. A referring student could receive up to five incentives per year. The report stated that FSA identified two students who had already received the incentive and seven students who were scheduled to receive the incentive.

The four audits were of foreign schools and covered January 1, 2011, through December 31, 2011. Each audit report included a finding that the school had contracts in place that provided for incentive compensation payments to individuals or entities engaged in

recruiting or admitting activities or in making decisions regarding the awarding of Title IV funds. These audit reports also stated that school management had commenced procedures to ensure the contracts were rectified or terminated to ensure compliance with the incentive compensation requirements. However, the audit reports did not contain sufficient detail for FSA to make informed decisions regarding enforcement of the incentive compensation ban. The reports did not include information identifying with whom the school contracted, explaining whether the school actually paid incentive compensation, or indicating the extent of the noncompliance. The audit reports did not clarify whether the schools paid incentive compensation for recruiting Title IV-eligible students or foreign students, or both. According to section 487(a)(20) of the HEA and 34 C.F.R. § 668.14(b)(22)(i)(A), the ban on incentive compensation does not apply to the recruitment of foreign students residing in foreign countries who are not eligible to receive Title IV funds.

In addition to the one program review and four audits described in this finding, as of November 14, 2014, FSA had not resolved a 2011 audit report issued by our office that disclosed Ashford University designed a compensation plan for enrollment advisors that provided incentive payments based primarily on success in securing enrollment. Ashford University did not provide documentation demonstrating that its compensation plan qualified for one of the safe harbors in effect at the time of our audit (A05I0014, January 2011). FSA has yet to determine whether Ashford University was or is in compliance with the new regulations.

FSA Procedures Call for Consultation With AAASG If Potential Incentive Compensation Findings Are Identified

FSA's program review manual and FSA's compliance audit manual for foreign schools stated that the Department delegated to AAASG its authority to fine, limit, suspend, terminate, and impose emergency actions against schools that violate Title IV program requirements. FSA required AAASG to evaluate the merits of each case and, in consultation with the Office of the General Counsel, determine the final action to be initiated.

Effective June 21, 2012, if a program review report or preliminary audit determination letter included a finding related to incentive compensation, the program review or audit resolution team was required to consult with AAASG before issuing the preliminary program review report or draft audit determination letter. AAASG was required to make a preliminary determination regarding whether to include referral language for a possible fine in the final program review determination letter or final audit determination letter. FSA began resolving each of the five incentive compensation findings after these procedures became effective.

The procedures for consulting with AAASG were communicated to Program Compliance's employees, including those in the foreign school participation division, by email from a Performance Improvement and Procedure Services Group program review liaison. According to meeting minutes, the procedures were also communicated by conference call, at which the foreign schools participation division was an anticipated meeting participant. The conference call minutes did not indicate whether audit resolution specialists from the foreign schools participation division were present. Neither the email nor the conference call minutes indicated that the procedures did not apply to the resolution of foreign school audits. Both communications included a note that the program review and compliance audit manuals would be updated to include these new procedures. The procedures were added to FSA's program review and compliance audit manuals, both dated November 2, 2012. However, the compliance

audit manual for foreign schools was not updated to include the procedures (the last revision to this manual was September 15, 2010).

No Consultation With AAASG Regarding Final Actions to Be Initiated

For the program review report that included an incentive compensation finding, the program review team did not consult with AAASG before issuing the preliminary program review report to the school. According to an email between an AAASG specialist and the division director and compliance manager of the school participation division that issued the report, AAASG reminded the school participation division of this requirement. AAASG stated that the program review team should have requested from AAASG a preliminary determination regarding a possible fine before issuing that preliminary program review report.

The foreign school participation division resolved each of the four incentive compensation findings in the IPA audit reports without any consultation with AAASG. Although FSA sustained the incentive compensation findings in the four IPA audit reports, it did not take any enforcement actions against the schools. In the final audit determination letters, FSA stated that the schools had already addressed or will address the issues, the issues were closed, and no further actions were required.

Quarterly, FSA conducted quality control reviews that covered program reviews and the resolution of IPA audit reports. However, the quality control reviews did not include procedures to determine whether program review teams and audit resolution teams consulted with AAASG on incentive compensation findings. FSA provided us with documents related to a new quality assurance review program that began October 1, 2013, and was designed to evaluate the quality of program reviews. The new quality assurance program uses a review group that is responsible for ensuring that applicable procedures were followed and issues identified during a program review are supported. This quality assurance process is to include a review of incentive compensation procedures. This new quality assurance review program, like the one in place before October 1, 2013, does not include specific requirements for the review group to confirm that the program review and audit resolution teams consulted with AAASG before resolving any incentive compensation findings.

Merits of Incentive Compensation Violations Identified in IPA Audit Reports Not Determined

According to FSA's compliance audit manual for foreign schools, depending on the severity of the finding, an incentive compensation violation is a circumstance where the audit resolution specialist will send a preliminary audit determination letter to the school requesting additional information related to the finding. However, we found that audit resolution specialists from the foreign school participation division resolved each of the incentive compensation findings disclosed in the four IPA audit reports without issuing a preliminary audit determination letter.

Based on our review of the four IPA audit reports and the related management responses, none of the four IPA audit reports contained sufficient detail for FSA to make an informed decision regarding enforcement of the incentive compensation ban without following up with the school or auditor, or both. Two of the reports did not indicate whether the school actually paid incentive compensation, one indicated that the school actually made incentive payments, and one indicated that the school did not actually make incentive payments. Because the IPA audit reports did not contain sufficient detail for FSA to make an informed decision

regarding enforcement of the incentive compensation ban, the audit resolution specialists should have obtained additional information through the use of preliminary audit determination letters.

When institutional review specialists and audit resolution specialists do not consult with AAASG regarding final actions to be initiated and do not determine the merits of each incentive compensation violation using a preliminary audit determination letter, FSA cannot (1) determine the extent of each incentive compensation violation, (2) ensure that adequate corrective actions were taken, or (3) ensure that it took enforcement actions sufficient to mitigate the risk of future incentive compensation violations.

Recommendations

We recommend that the Chief Operating Officer for FSA—

- 3.1 Enhance FSA’s quality assurance processes by including steps for the review group to confirm that FSA institutional review and audit resolution specialists consulted with AAASG regarding potential incentive compensation findings before issuing program review reports and preliminary audit determination letters.
- 3.2 Ensure that audit resolutions specialists sufficiently determine the merits of all future incentive compensation violations by using preliminary audit determination letters, when such letters are necessary to obtain additional information regarding findings, and by consulting with AAASG regarding potential enforcement actions to be initiated.

FSA Comments

FSA agreed with both recommendations. Although it agreed with the second recommendation, FSA did not agree with our conclusions concerning the resolution of the four IPA audits discussed in the finding. FSA stated that the audit resolution specialists had all the relevant facts needed to appropriately resolve all four IPA audits. FSA stated that two of the four IPA audit reports and the related management responses provided sufficient evidence to establish that the schools actually paid incentive compensation. Additionally, the management responses for the other two IPA audit reports included evidence that the school did not actually pay incentive compensation.

Office of Inspector General Response

We revised Finding No. 3 to more clearly state that we based our conclusions on a review of all four IPA audit reports and the related management responses before concluding that the information in all four cases was insufficient to make a fully informed decision.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our audit were to determine whether FSA (1) sufficiently revised its enforcement procedures and guidance so that they facilitated and did not hinder enforcement actions, (2) adapted and followed its methods to track monitoring activities related to incentive

compensation and detect incentive compensation ban violations, and (3) properly resolved incentive compensation ban findings. As stated in the original audit notification for this audit that we sent to the Department's Under Secretary and FSA, we initially planned to also determine whether a sample of schools were in compliance with the regulations governing incentive compensation. However, after sending the notification to the Department, we decided not to pursue this objective because it was not directly related to the Department's oversight of schools' compliance with the incentive compensation regulations. We evaluated the Department's operations as of June 25, 2014. The purpose of this report is to assist the Department in improving its oversight of schools' compliance with the incentive compensation ban.

To achieve our objectives, we gained an understanding of selected provisions of the HEA, Title IV regulations, and the Department's procedures, guidance, and practices related to resolving incentive compensation ban findings and detecting and tracking incentive compensation ban violations that were in effect from July 1, 2011, through June 25, 2014. We used "Standards for Internal Control in the Federal Government" (GAO/AIMD-00-21.3.1, November 1999) as criteria for evaluating the Department's system of internal control related to mitigating the risks of incentive compensation ban violations. In addition, we reviewed prior Office of Inspector General and GAO audits relevant to our objectives (see the Background section of this report for more details on the prior [GAO reports](#)).

To gain an understanding of FSA's system of internal control over resolving incentive compensation ban findings and detecting and tracking incentive compensation ban violations, we reviewed FSA's procedures, guidance, and practices that were in place from July 1, 2011, through June 25, 2014. We also reviewed FSA's program review and FSA's compliance audit manuals, the Hansen Memo, FSA's general fine guidance document, and a list of fines that FSA previously imposed on schools that violated the incentive compensation ban. In addition, we interviewed officials and employees from FSA's Program Compliance and Risk Management divisions. From Program Compliance, we interviewed the Chief Compliance Officer; Deputy Chief Compliance Officer; the directors of the AAASG, the Performance Improvement and Procedure Services Group, and the School Eligibility Service Group; and compliance managers and institutional review specialists from the seven domestic school participation divisions. From Risk Management, we interviewed the Chief Risk Officer and the directors of the Risk Analysis and Reporting Group and the Internal Review Group. We also interviewed two attorneys from the Office of the General Counsel. The attorneys assisted FSA with resolving incentive compensation violations. We concluded that FSA's system of internal control did not provide reasonable assurance that FSA detected and properly resolved incentive compensation violations (see the section "[Weaknesses in FSA's System of Internal Control](#)," on page 20 in Finding No. 2, and Finding No. 3, "[FSA Did Not Properly Resolve Incentive Compensation Findings Identified in Program Reviews and Audits](#)," on page 21).

Finally, we reviewed and analyzed the Department's comments on the draft of this report and revised the report as necessary.

Sampling Methodology

To achieve our objectives, we judgmentally selected a sample of 26 program reviews from a universe that included 253 program reviews that (1) FSA started from July 1, 2011, through September 17, 2013; (2) included a review of at least 1 award year that began July 1, 2011,

or later; (3) included incentive compensation in the scope of review; and (4) had a program review report issued.¹¹ We judgmentally selected the only program review in our universe with an incentive compensation finding and the only incentive compensation-focused review in our universe. When judgmentally selecting the other 24 program reviews, we ensured that we included at least 2 program reviews completed by each of FSA's 10 offices from the 7 domestic school participation divisions, at least 1 of each of the 3 types of reviews that FSA conducted, 3 types of schools FSA reviewed (proprietary, private nonprofit, public), and 4 types of deficiency levels (moderate, serious, very serious, and no regulatory violations) as determined by FSA. We also ensured that we included at least one program review for which FSA had made a final determination.

Because we judgmentally selected these 26 program reviews, our results might not be representative of the population and cannot be projected to the 227 program reviews from our universe that we did not review.

Review of Program Review Files

For each of the 26 program reviews, we reviewed program review files for evidence that institutional review specialists completed the incentive compensation testing procedures and finding resolution procedures required by FSA's program review manual. Depending on the type of review being conducted, FSA's program review manual required institutional review specialists to complete some or all of the following procedures: review the school's policies and procedures related to recruiter compensation and incentive programs, interview school employees who were engaged in recruitment or admissions activities, review payroll history and personnel files of employees who were engaged in recruitment or admissions, and document the results of testing in the appropriate worksheet.

Review of Policies and Procedures

We reviewed the program review files for documentation of the specific policies and procedures that the institutional review specialists reviewed. We also looked for evidence that institutional review specialists determined whether the policies and procedures were in compliance with the incentive compensation regulations. As sufficient evidence of a review of the policies and procedures, we accepted a copy of the policies and procedures, a narrative of the policies and procedures, or notations by institutional review specialists describing the specific policies and procedures that they reviewed. In addition, we looked for a completed Incentive Compensation Worksheet, which, according to FSA's program review manual, was to include a conclusion about whether the school's policies and procedures complied with the incentive compensation regulations. Overall, we accepted any evidence, such as notations written on the program review file copy of the school's policies and procedures, that might reasonably indicate that institutional review specialists made the required determination.

Interviews

We looked for notes of interviews that institutional review specialists conducted with school employees who were engaged in recruitment or admissions activities. We accepted interviews

¹¹ To identify our universe, we applied these criteria to a list of all program reviews conducted by FSA from July 1, 2011, through September 17, 2013, as identified by FSA using queries of PEPS. FSA queried the start date, scope of review, and program review report fields as of December 17, 2013. FSA queried the award year reviewed field as of January 17, 2014.

of employees in recruitment, admissions, and enrollment departments, as well as employees in other departments if we could determine that the interview included a discussion about incentive compensation.

Review of Payroll History and Personnel Records

We looked for evidence that institutional review specialists reviewed payroll history and personnel records for the past 2 calendar years for at least 25 percent of school employees engaged in recruiting or admissions activities. We also looked for evidence that institutional review specialists obtained an understanding of fluctuations in pay amounts and reviewed the personnel records for indications the school was tracking recruitment employees by their enrollment numbers.

Document Results of Testing

We looked for evidence of a completed Incentive Compensation Worksheet or Incentive Compensation Expanded Worksheet.

Consult With AAASG

Only one program review included in our universe identified an incentive compensation violation. We looked for evidence that the program review team consulted with AAASG regarding the incentive compensation finding before issuing the draft program review report.

Review of FSA's IPA Audit Resolution Files

We reviewed the IPA audit resolution files that documented FSA's resolution process for all four annual IPA audit reports that covered the period from July 1, 2011, through June 30, 2013, and disclosed incentive compensation findings. All four reports covered the audit period ended December 31, 2011, and were resolved by the foreign schools participation division.

We reviewed FSA's files for evidence that audit resolution specialists completed the resolution procedures required by the compliance audit manual for foreign schools, including consultation with AAASG before issuing preliminary audit determination letters. We also looked for evidence that audit resolution specialists determined the merits of the incentive compensation findings using preliminary audit determination letters. For each of the four reports, we reviewed audit resolution documentation, such as the subsequent year's audit report, the audit resolution analysis checklist or audit resolution checklist, and final audit determination letter contained in FSA's files.

Data Reliability

To achieve our objectives, we relied, in part, on data from PEPS, which contains data fields related to program reviews and IPA audits of schools. We assessed the sufficiency and appropriateness of this data by applying logic tests, including tests for missing data, the relationship of one data element to another, values outside a designated range, and dates outside valid time frames or in an illogical progression. For the program review and IPA audit reports that we reviewed, we confirmed that PEPS data matched information on source documents that FSA maintained in each program review and IPA audit file. We did not identify any significant discrepancies or limitations. Therefore, we concluded that the data were sufficiently reliable for our intended uses.

We conducted our audit from August 2013 through June 2014 at the Department's offices in Washington, D.C., and our offices in Chicago, Illinois, and Kansas City, Missouri. We

conducted interviews with Department employees in person and by telephone. We discussed the results of our work with Department officials on September 26, 2014.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

ADMINISTRATIVE MATTERS

Statements that managerial practices need improvements, as well as other conclusions and recommendations in this report, represent the opinions of the Office of Inspector General. Determinations of corrective action to be taken will be made by the appropriate Department of Education officials.

Corrective actions proposed (resolution phase) and implemented (closure phase) by your office will be monitored and tracked through the Department's Audit Accountability and Resolution Tracking System (AARTS). Department policy requires that you develop a final corrective action plan (CAP) for our review in the automated system within 30 calendar days of the issuance of this report. The CAP should set forth the specific action items, and targeted completion dates, necessary to implement final corrective actions on the findings and recommendations contained in this final audit report.

In accordance with the Inspector General Act of 1978, as amended, the Office of Inspector General is required to report to Congress twice a year on the audits that remain unresolved after six months from the date of issuance.

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

We appreciate the cooperation given us during this review. If you have any questions or require additional information, please do not hesitate to contact me at (202) 245-6949; Gary Whitman, Regional Inspector General for Audit, at (312) 730-1658; or Lisa F. Robinson, Assistant Regional Inspector General for Audit, at (816) 268-0519.

Sincerely,

/s/

Patrick J. Howard
Assistant Inspector General for Audit

Attachment 1

Acronyms, Abbreviations, and Short Forms Used in this Report

AAASG	Administrative Actions and Appeals Service Group
C.F.R	Code of Federal Regulations
Department	U.S. Department of Education
eZ-Audit	A web-based, automated system for audit submissions
FSA	Federal Student Aid
GAO	United States Government Accountability Office
HEA	Higher Education Act of 1965, as amended
Hansen Memo	An October 30, 2002, internal memorandum from the Deputy Secretary of Education to the Chief Operating Officer of Federal Student Aid
IPA	Independent public accountant
OMB	Office of Management and Budget
PEPS	Postsecondary Education Participants System
SFA Audit Guide	Audit Guide for Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers
Title IV	Title IV of the Higher Education Act of 1965, as amended

Attachment 2

MEMORANDUM

DATE: February 18, 2015

TO: Gary D. Whitman
Regional Inspector General for Audit
Office of Inspector General

FROM: James W. Runcie
Chief Operating Officer

SUBJECT: Response to Draft Audit Report:
Federal Student Aid's Oversight of Schools' Compliance with the Incentive
Compensation Ban
Control No. ED-OIG/A05N0012

Thank you for the opportunity to comment on the Office of Inspector General's (OIG) draft audit report, *Federal Student Aid's Oversight of Schools' Compliance with the Incentive Compensation Ban*, dated November 26, 2014. The objectives of the audit were to determine whether Federal Student Aid (FSA) 1) sufficiently revised its enforcement procedures and guidance so that they facilitated and did not hinder enforcement actions, 2) adapted and followed its methods to track monitoring activities related to incentive compensation and to detect incentive compensation ban violations, and 3) properly resolved incentive compensation ban findings.

FSA agrees that compliance with the incentive compensation ban is an important component of schools' compliance with Title IV requirements. To that end, in FY 2014, FSA implemented a quality control process to ensure that our staff is adhering to program review procedures, including those procedures regarding incentive compensation. Each School Participation Division has also instituted its own checks of program review procedures, e.g., checks to assure worksheets are properly completed, work papers are complete, trainees are provided guidance and assistance by more senior reviewers, supervisory review of work papers and documentation, etc.

While we don't disagree that the Department may need to consider new policy guidance and implementing procedures, FSA's enforcement practices during OIG's review were in accordance with current Department policy and procedures. The Department's efforts to strengthen enforcement of the incentive compensation ban have been challenged in the courts in recent years. Therefore, we have been working closely with legal counsel on decisions involving incentive compensation ban violations as well as related policy and procedural matters. In addition, FSA is in the process of determining the impact of the District Court decision (https://ecf.dcd.uscourts.gov/cgi-bin/show_public_doc?2014cv0277-22) regarding incentive compensation, as this decision impacts FSA's corresponding procedures.

FSA's comments and responses to the nine (9) recommendations in OIG's draft audit report are listed below.

FINDING NO. 1 - Enforcement Policies and Procedures Not Sufficient to Ensure Appropriate and Consistent Actions Against Schools That Violate the Incentive Compensation Ban

RECOMMENDATION 1.1 — Request that the Deputy Secretary of Education rescind the Hansen Memo and have FSA develop incentive compensation enforcement procedures and guidance that effectively make use of all enforcement actions available under the HEA.

RESPONSE:

FSA agrees with the first part of this recommendation, to request that the Hansen Memo be rescinded/replaced. We do not agree with the second part of this recommendation, to develop incentive compensation procedures and guidance that effectively make use of all enforcement actions available under the HEA, since such processes and practices already exist. However, we will document the current adverse action processes and practices, including incentive compensation enforcement actions, and make changes as needed to clarify how FSA effectively makes use of all enforcement actions available under the HEA.

The OIG states (p.1, paragraph 2; p. 6-7, bridging paragraph; p. 7-9) that FSA did not revise its enforcement procedures and guidance to ensure that they facilitated rather than hindered enforcement actions after the Department eliminated the incentive compensation safe harbors in 2010. The OIG also asserts that FSA did not develop procedures and guidance instructing "employees" on how they should determine the appropriate enforcement action for incentive compensation violations.

OIG specifically states in Finding #1 that FSA has not developed "procedures and guidance explaining when and how to apply all of the various types of enforcement actions available when schools violated the incentive compensation ban," and that as a result of this, fines were generally the only enforcement action that FSA used to punish violators of the ban. The OIG states that FSA did not provide guidance "explaining when and how to apply the other types of enforcement actions available under the HEA and Title IV regulations."

FSA need not have guidance instructing FSA employees on how they should determine appropriate enforcement action because only the Administrative Actions and Appeals Service Group (AAASG) Director (in consultation with the Department's Office of the General Counsel-OGC) does so, as the OIG noted on p. 5 paragraph 6.

The Director of AAASG makes enforcement determinations in accordance with the delegated authority from the Secretary of Education, the Hansen memo and internal guidance, none of which was affected by the elimination of the safe harbors in 2010.

Further, incentive compensation violations are only one small category of regulatory and statutory violations that are referred to AAASG. Whatever the type of violation, an appropriate enforcement action will be determined based on the facts and circumstances of each case: the school's participation may be ended in the manner consistent with its certification status (termination, denial of a pending application, revocation of a provisional PPA), and/or a fine

may be imposed. The enforcement actions available to AAASG when schools violate the incentive compensation ban are not any different from those available for any violation of the statutes and regulations governing the Title IV, HEA programs. FSA need not have procedures specific to incentive compensation violations to inform the AAASG Director of the range of possible adverse actions against an institution as a result of such a violation.

As you know, the Department's current enforcement policy regarding violations of the prohibition on incentive compensation is set forth in the October 30, 2002 memo from William D. Hansen, then Deputy Secretary of Education, to Terri Shaw, then Chief Operating Officer, FSA, entitled "Enforcement policy for violations of incentive compensation prohibition by institutions participating in student aid programs" (Hansen memo). According to the Hansen memo, the Department treats a violation of § 487(a)(20) of the HEA as a compliance matter for which remedial or punitive sanctions should be considered, rather than as a violation that results in monetary loss to the Department, which was the Department's prior policy. Below is an excerpt from that memo.

"...In some instances, violations of the prohibition, either themselves or in combination with other program violations, may constitute a basis for limitation, suspension, or termination action. However, much more commonly, the appropriate sanction to consider will be the imposition of a fine."

The OIG has based its finding that FSA has not ensured that it takes sufficient, appropriate, and consistent enforcement actions upon its belief that fines are the only enforcement actions that FSA uses to punish violations of the incentive compensation ban. The OIG indicates that although pursuant to 20 U.S.C. § 1094(c) and 34 C.F.R. Part 668 Subpart G, the Department may initiate emergency, limitation, suspension, or termination actions, in addition to fine actions, against institutions that participate in a Title IV program, FSA has not limited, suspended, or terminated any institution's participation in the Title IV programs based upon violation of the incentive compensation ban.

The adverse actions that the Department may take are not limited to administrative actions pursuant 20 U.S.C. § 1094(c) and 34 C.F.R. Part 668, Subpart G. The Department may also revoke an institution's provisional program participation agreement pursuant 20 U.S.C. 1099c(h) and 34 C.F.R. § 668.13(d), or may deny a pending application for recertification pursuant to 20 U.S.C. 1099c(g) and 34 C.F.R. § 668.13(a). In fact, FSA has revoked the provisional program participation agreement of a school pursuant to the provisions of 34 C.F.R. § 668.13(d)(1), based in part upon that institution's illegal payment of incentive compensation to admissions representatives employed at the institution.

However, FSA's predominant use of fine actions to enforce the incentive compensation ban is completely in accordance with the enforcement policy as set forth in the Hansen memo, and serves to illustrate that the Department's policy is being consistently followed by FSA. Further, because all of FSA's adverse actions based on a violation of the incentive compensation ban are reviewed by the Office of the General Counsel (OGC) to determine the legal sufficiency and the merits of the case prior to issuance, FSA is confident that the enforcement actions taken have not only been consistent, but have also been sufficient and appropriate. No evidence has been presented to demonstrate that FSA and OGC's determinations, based on their significant legal

expertise and years of experience, were incorrect or that FSA should have taken a different enforcement action in any particular case.

RECOMMENDATION 1.2 — Develop written procedures and guidance explaining when to apply the various types of enforcement actions (sections 487 and 498 of the HEA and 34 C.F.R. Part 668) against schools that violate the incentive compensation ban.

RESPONSE:

FSA disagrees with this recommendation. The basis for our disagreement is discussed below. Nonetheless, as part of the documentation of the current adverse action processes and practices, including incentive compensation enforcement actions, completed under 1.1, FSA is willing to determine what changes are needed to clarify further when to apply the various types of enforcement action (sections 487 and 498 of the HEA and 34 C.F.R. Part 668) against schools that violate the incentive compensation ban.

On p.1, paragraph 2 and p. 6-7, bridging paragraph, the OIG alleges that the Hansen Memo, issued by the Deputy Secretary of Education in 2002, and the internal procedures that FSA developed and implemented, discouraged FSA employees from using all available enforcement actions at FSA's disposal.

The Hansen Memo provides that, rather than identifying as a liability the total amount of student aid provided to each improperly recruited student, a violation of the incentive compensation prohibition should be treated as a compliance matter for which remedial or punitive sanctions should be considered.

With regard to appropriate penalties, as discussed in FSA's response to Recommendation 1.1, the guidance in the Hansen Memo states:

“In some instances, violations of the prohibition, either themselves or in combination with other program violations, may constitute a basis for limitation, suspension, or termination action. However, much more commonly, the appropriate sanction to consider will be the imposition of a fine.”

FSA's considerable experience, after review of numerous cases, has in fact been that, if a violation is viewed as a matter to be addressed by remedial or punitive sanctions rather than as resulting in a liability, most commonly the appropriate sanction is indeed the imposition of a fine. In an instance wherein the violation of the prohibition, in combination with other program violations, warranted ending the school's participation in the Title IV, HEA programs, AAASG took the appropriate action based upon the school's certification status (a revocation.) Thus, there is no demonstrated basis for the OIG's statement (at p. 7, paragraph 1) that “...fines will likely continue to be the *only* (emphasis added) enforcement action that FSA uses to punish violators of the incentive compensation ban.”

The OIG has not identified a single instance wherein the enforcement action that FSA initiated was not the appropriate action given the circumstances of the case, or wherein all possible adverse actions were not considered by the AAASG Director.

The OIG's apparent disagreement with the "Hansen Memo" does not support its conclusion that FSA developed internal procedures and guidance that discouraged FSA employees from using all allowable enforcement actions. On p. 9-10, bridging paragraph, the OIG states "FSA employees were hesitant to take appropriate action against institutions that might have violated the incentive compensation ban." The OIG offers no support for this statement. The only relevant employee is the Director of AAASG, who did not develop and implement guidance to discourage using all allowable enforcement actions. In fact, at no time did AAASG hesitate to take appropriate adverse action based upon violations of the incentive compensation ban.

The OIG's misunderstanding of whom within FSA determines enforcement actions is evidenced by the following text, excerpted from the second full paragraph of page 8: "FSA's own guidance to its employees further encouraged the use of fines for schools that violated the incentive compensation ban. According to an email from a Performance Improvement and Procedure Service Group program review liaison, institutional review specialists and audit resolution specialists must consult with AAASG on incentive compensation violations so that AAASG can make a preliminary determination regarding a possible fine. The email did not mention the possibility of any enforcement actions other than fines." Institutional review specialists (IRS) and audit resolution specialists (ARS) do not determine the appropriate enforcement action for incentive compensation violations. The OIG's assumption that the inexact wording of Performance Improvement and Procedure Service Group (PIPSG) guidance issued to IRSs and ARSs somehow encourages the AAASG Director to determine that a fine is the appropriate remedy is without merit.

On p. 9, paragraph 2, the OIG states that the Department must create and maintain official records that are sufficient to ensure adequate documentation of its decision. Each adverse action document that AAASG issues sets forth the basis upon which the Department determined a fine or other action was warranted, and the basis upon which the amount of the fine was determined.

RECOMMENDATION 1.3 — Clarify existing guidance for determining fine amounts for schools that violate the incentive compensation ban. At a minimum, clarification should cover how the number of incentive compensation violation occurrences should be determined and whether incentive compensation violations should result in a single institutional fine or a larger fine based on multiple incentive compensation violation occurrences.

RESPONSE:

FSA partially agrees with this recommendation, as discussed below. Nonetheless, FSA is willing to clarify further the current fine guidance and make any changes as needed to describe how the number of incentive compensation violation occurrences should be determined and whether incentive compensation violations should result in an institutional fine, a fine based on multiple incentive compensation violation occurrences, or a combination thereof.

The first paragraph under Finding #1 on p. 7 and p. 9 paragraphs 3-5, the OIG states that the "procedures and guidance that FSA used to initiate fines did not clearly describe how FSA employees should determine the amount of a fine resulting from an incentive compensation violation." The OIG also states that FSA's guidance did not "clearly describe how the number of incentive compensation violations should be determined or whether incentive compensation violations should result in single institutional fine or a larger fine based on multiple incentive compensation occurrences."

The amount of the fine for incentive compensation violations is determined by the Director of AAASG in accordance with the delegated authority from the Secretary of Education, the Hansen Memo and internal guidance. FSA need not issue additional guidance to FSA employees describing how to determine the amount of a fine.

Regarding consistent enforcement of the ban with respect to the amount of the proposed fine, the Hansen Memo clearly states: “In determining the amount of a fine, the Office of Federal Student Aid (FSA) is to take into account the extent to which the institution appeared to be knowingly violating the law, as would be evidenced, for example, by attempts to disguise its compensation plan and by other aggravating factors, such as documented misrepresentations to prospective students. On the other hand, mitigating factors such as arguable reliance on Department guidance and on the reasonable advice of counsel, among other things, should also be taken into account. The size of the payments to persons or entities engaged in student recruiting and the pervasiveness of the improper practices across an institution’s enrollments should also bear on the magnitude of the fine to be imposed. In the exercise of its discretion, FSA may deem factors not described herein to be relevant to the determination of the amount of a fine.”

The general fine guidance document utilized by the AAASG Director, which the OIG referenced in paragraph 3 of page 9, in fact clearly describes how the number of occurrences of the violation is to be determined. Because of the varied and wide-ranging nature of incentive compensation violations, which include small bonuses paid to a few recruiters, complicated compensation plans implemented system-wide by large school groups, and scenarios the Department has not yet encountered or even conceived of, the guidance must be general to be useful and universally applicable. This guidance is sufficiently detailed for AAASG and OGC staff who work on incentive compensation issues and violations.

FINDING NO 2. - Procedures for Detecting Incentive Compensation Ban Violations Were Insufficient and Not Always Followed

RECOMMENDATION 2.1 — Require employees to complete all required incentive compensation testing procedures and document all conclusions reached regarding the school’s compliance with the incentive compensation regulations.

RESPONSE:

FSA concurs with this recommendation. FSA implemented Quality Control measures in FY 2014 that have identified needs for improvements and training. As well, School Participation Divisions have been reviewing their internal practices and providing training and mentoring where necessary, all of which address this recommendation.

FSA will revise the program review incentive compensation procedures and applicable forms and checklists to clarify the testing procedures and documentation that must be completed, and we will provide refresher staff training on incentive compensation testing procedures and documenting the results of testing.

RECOMMENDATION 2.2 — Stress the importance of institutional review specialists' understanding what constitutes an incentive compensation violation and the situations in which they should discuss with their supervisors whether any additions or adjustments to the program review work plan or interview questions are necessary.

RESPONSE:

FSA concurs with this recommendation. We will provide refresher staff training on incentive compensation violations and the situations in which they should consult with their supervisor.

RECOMMENDATION 2.3 — Revise the general and detailed incentive compensation testing procedures in the FSA program review manual to include procedures applicable to personnel and entities engaged in making decisions about awarding Title IV funds.

RESPONSE:

FSA concurs with this recommendation. As part of the response to Recommendation 2.1, FSA will revise the general and detailed incentive compensation testing procedures in the program review procedures to include procedures applicable to personnel and entities engaged in making decisions about awarding Title IV funds.

RECOMMENDATION 2.4 — Require supervisors to review program review documentation to ensure that institutional review specialists completed all required work, reached appropriate conclusions about a school's compliance with the incentive compensation regulations, and adequately supported their work and conclusions. Supervisors could sign relevant documentation or employ other methods to note their review.

RESPONSE:

FSA concurs with this recommendation. As part of the revision of the program review procedures, we will include appropriate supervisory review of the applicable forms, checklists and other documentation.

FINDING NO. 3 – FSA Did Not Properly Resolve Incentive Compensation Findings Identified in Program Reviews and Audits

RECOMMENDATION 3.1 — Enhance FSA's quality assurance processes by including steps for the review group to confirm that FSA institutional review and audit resolution specialists consulted with AAASG regarding potential incentive compensation findings prior to issuing program review reports and preliminary audit determination letters.

RESPONSE:

FSA concurs with this recommendation. As part of the QC review of program reviews, we will include steps for the review group to confirm that institutional review and audit resolution specialists consulted with AAASG regarding potential incentive compensation findings prior to issuing program review reports and preliminary audit determination letters.

RECOMMENDATION 3.2 — Ensure that audit resolutions specialists sufficiently determine the merits of all future incentive compensation violations by using preliminary audit determination letters, when such letters are necessary to obtain additional information regarding findings, and by consulting with AAASG regarding potential enforcement actions to be initiated.

RESPONSE:

Although FSA concurs with this recommendation, we have provided additional details below on the resolution of the audits in question. Also, we will provide refresher training to audit resolution specialists on using preliminary audit determination letters (PADL), including determining when such letters are necessary, to obtain additional information regarding findings and on consulting with AAASG regarding potential adverse actions to be initiated.

For Schools #1 and 4 in the OIG audit, the schools' audit reports and management responses provided sufficient evidence to establish that incentive payments were actually made, although the exact amount of payments made were not disclosed. The reports also indicated that both schools disbursed less than \$500,000 during the applicable fiscal year, which identifies the outer limit on the scope of the non-compliance. This information was reviewed by the audit resolution specialist.

Based on this information, the audit resolution specialists made a determination that no further information was needed to establish the relevant facts for a violation so a PADL was not necessary in either case. With respect to a failure to identify the amount of incentive payments made, this fact is irrelevant to the merits of the audit resolution because no amount of incentive compensation payment may be paid. It is enough to know that some amount of improper payment was made. There is no de minimus threshold. FSA's audit resolution specialists were in possession of all of the relevant facts when the audit was resolved.

For Schools 2 and 3, FSA disagrees that its audit resolution specialists failed to determine the merits of each incentive compensation violation such as whether payments were actually made. Managements' comments in the audit reports makes evident that incentive compensation payments were not actually made, and that information was reviewed by the audit resolution specialists when they resolved the audits. No further information was needed to establish the relevant facts for a violation so a PADL was not necessary because FSA expected that the schools would have replied to the PADL with the same information already contained in the audit; namely, the contracts could have allowed improper payments, but no payments were actually made. FSA's audit resolution specialists were in possession of all of the relevant facts when the audit was resolved.

Two institutions violated the requirement in practice, while two others had not. In terms of establishing the adequacy of the audit resolution, each institution in question stated that it was reviewing and amending its contracts, or had already done so, and the subsequent audit reports confirmed the adequacy of the institutions' corrective actions by the absence of a repeat finding.

In addition, ED OCFO's Post-Audit Handbook states:

“In developing PDLs for audit findings, the cooperative audit resolution specialist must take into consideration the following:

- All responses from the auditee.
- All information included in the audit report.
- Prior audit reports, PDLs, appeal decisions and other related documents issued for the auditee as they apply to the current findings requiring resolution.

These documents should be obtained and reviewed by the specialist before program PDLs are prepared on findings included in the audit report.”

The Post-Audit Handbook also states:

“In many cases, audits can be resolved based upon the information contained in the audit report. Requests for *all* audit documentation related to a particular audit should be *avoided* whenever possible.” (emphasis in original).

FSA’s audit resolution specialists’ decisions to avoid requesting additional documentation is consistent with the OCFO’s guidance in the Post-Audit Handbook.

In addition, the Post-Audit Handbook states with respect to “Findings Involving Non-monetary Matters”:

“If information included in the audit report or subsequent information provided by the auditee indicates that appropriate corrective action is underway, with reasonable assurances that the necessary action will be completed by a specific date, the AO may accept these assurances and consider the finding resolved”

Again, thank you for the opportunity to comment on the draft audit report. If you have questions about the response, please let us know.

Attachments