



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

**MEMORANDUM**

SEP - 4 2002

**TO :** James Manning  
Acting Chief Operating Officer  
Federal Student Aid

**FROM :** Thomas A. Carter  
Assistant Inspector General for  
Audit Services

**SUBJECT:** Final Audit Report  
***AUDIT OF COMMISSIONED SALES AND COURSE LENGTH AT  
SOUTHERN WESLEYAN UNIVERSITY***  
Control Number ED-OIG/A06-A0024

Attached is our subject report presenting findings resulting from our audit of Southern Wesleyan University.

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

If you have any questions or wish to discuss the contents of this report, please contact Sherri Demmel, Regional Inspector General for Audit, Dallas, Texas, at 214-880-3031. Please refer to the audit control number in all correspondence relating to this report.

Attachment



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

SEP - 4 2002

Dr. David J. Spittal, President  
Southern Wesleyan University  
P.O. Box 1020  
907 Wesleyan Dr.  
Central, SC 29630-1020

Dear Dr. Spittal:

This **Final Audit Report** (A06-A0024) presents the results of our Audit of Commissioned Sales and Course Length at Southern Wesleyan University (University). Our objectives were to determine whether the University complied with the Higher Education Act's (HEA) prohibition against the use of incentive payments for recruiting activities and with the HEA's required minimum number of instructional hours.

## AUDIT RESULTS

We found that the University was not in compliance with the statutory prohibition on the use of incentive payments for recruiting based on success in securing student enrollments when it paid the Institute for Professional Development (IPD) a percentage of tuition for all students enrolled in its Adult and Graduate Studies (Adult Studies) programs. As a result of incentive payments made to IPD, the University is liable for \$19,451,123 in Title IV funds awarded to students in the Adult Studies programs who were improperly recruited.

We also found that the University's documentation supporting the actual number of instructional hours spent in study groups used in the definition of an academic year for its Adult Studies programs did not provide the number of instructional hours required to meet the statutory definition of an academic year. The statutory definition of an academic year is set forth in 34 C.F.R. § 668.2(b). The regulations in this section that apply to institutions not using semester, trimester, or quarter systems are commonly known as the 12-Hour Rule. The 12-Hour Rule requires the equivalent of at least 360 instructional hours per academic year. An institution's academic year and the credit hours that a student is enrolled in are used, in part, to determine the amount of funds a student is eligible to receive from the Title IV programs. We estimated that the University over awarded and disbursed Title IV funds totaling \$4,768,997 on behalf of its Adult Studies students. (This amount is included in our finding on instructional time.)

We provided a draft of this report to the University. In its response, the University disagreed with the findings and recommendations. After reviewing the University's response, we did not change the findings or recommendations. We have summarized the University's comments after the applicable recommendations. A copy of the complete response is enclosed with this report.

**Finding 1 - Institutions Participating in the Title IV Programs Must Not Provide Payments Based on Success in Securing Enrollments to Any Person or Entity Engaged in Recruiting**

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

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

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

The regulations at 34 C.F.R. § 668.14(b)(22) codify the statutory prohibition on incentive payments based on securing enrollment:

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

**IPD Recruited Students and Received Payments Based on Student Enrollment in the Adult Studies Programs**

The University entered into a contract with IPD that provided for incentive payments to IPD based on success in securing student enrollments for its Adult Studies programs. The contract stated that “IPD is a recruiting service organization assisting Southern Wesleyan University in recruiting students for the programs.” The contract included the following specific responsibilities for IPD:

- IPD shall recruit students to enroll in the courses of study in the Adult Studies programs.
- IPD shall provide representatives to recruit students for the Adult Studies programs.
- IPD shall collect, on behalf of Southern Wesleyan University, all tuition, application fees, book and material fees, and other fees applicable to the programs.
- IPD shall maintain the official program accounting books and records.

IPD remitted book and material fees in full to the University. Tuition fees were divided between the parties on a weekly basis. During the period of our audit, in accordance with the contract, the division ranged from 50 percent to the University and 50 percent to IPD to 70 percent to the

University and 30 percent to IPD. The ratios were student-specific for as long as students maintained continuous enrollment. For example, revenue for students who enrolled under a 60/40 ratio would still be divided on the basis of that ratio even if the ratio changed in a subsequent year for incoming students. Refunds were also paid according to those percentages. In contracting with IPD to provide recruiting services, the University violated the statutory and regulatory provisions quoted above by paying IPD a percentage of tuition for each student IPD recruited.

### **The University Violated the HEA by Paying IPD Based on Success in Securing Enrollments for the Adult Studies Programs Which Resulted in \$19,451,123 of Improperly Disbursed Title IV Funds**

Because the University did not comply with the HEA and regulations by paying incentives to IPD based on success in securing student enrollments for its Adult Studies programs, the University must return all Title IV funds that were disbursed on behalf of students enrolled in the Adult Studies programs who were improperly recruited. Because the University paid incentives for each student enrolled in the Adult Students programs, all students in the programs were improperly recruited. Our audit covered the period July 1, 1997, through June 30, 2000. For that period, Title IV funds totaling \$19,451,123 were disbursed on behalf of students enrolled in the Adult Studies programs, consisting of \$18,346,658 in Federal Family Education Loan Program (FFEL), \$1,079,565 in Federal Pell Grant Program (Pell), \$21,400 in Federal Supplemental Educational Opportunity Grant Program (FSEOG), and \$3,500 in Federal Perkins Loan Program (Perkins) funds.

### **IPD Recruiters Received Salary and Bonuses Based on the Number of Students Enrolled in the Adult Studies Programs**

Our review of IPD's compensation plans for Fiscal Years (FY) 1997-1999 disclosed that IPD provided incentives to its recruiters through salary levels that were based on the number of students recruited and enrolled in the programs. According to the plans, IPD assigned recruiters a salary within the parameters of performance guidelines (that is, knowledge of basic policies and procedures, organization and communication skills, and working relationships). IPD assessed recruiter performance on a regular basis, comparing it to the established goals for the fiscal year. The plans stated that IPD would complete formal evaluations biannually and, after the first six months of employment, determine salary on an annual basis. The plans showed that the recruiter's success in enrolling students determined whether IPD adjusted the salary upward, downward, or kept it the same. In addition, the FY 1998 and 1999 compensation plans called for the payment of bonuses to recruiters hired before September 1, 1997, and September 1, 1998, respectively. The bonuses increased as the number of students increased, and ranged from \$1,344 for recruiting 100 students to \$29,600 for recruiting over 200 students. The FY 1999 plan indicated that recruiters hired on or after September 1, 1998, who achieved 100 or more students enrolled in and starting classes by the end of the fiscal year, were entitled to a one-time bonus of \$1,500. In contracting with IPD, the University was not in compliance with 34 C.F.R. § 668.14(b)(22) because IPD paid its recruiters incentive compensation based on success in securing enrollments.

## RECOMMENDATIONS

We recommend that the Chief Operating Officer for Federal Student Aid (FSA) require the University to:

- 1.1 Amend and/or terminate immediately its present contractual relationship with IPD to eliminate incentive payments based on success in securing student enrollments.
- 1.2 Return to lenders \$18,346,658 of FFEL disbursed on behalf of students enrolled in the Adult Studies programs during the period July 1, 1997, through June 30, 2000, and repay the Department for interest and special allowance costs incurred on Federally-subsidized loans.
- 1.3 Return to the Department \$1,079,565 of Pell, \$21,400 of FSEOG, and \$3,500 of Perkins disbursed to students enrolled in the Adult Studies programs during the period July 1, 1997, through June 30, 2000.
- 1.4 Determine the amount of FFEL, Pell, FSEOG, and Perkins funds improperly disbursed to or on behalf of students since the end of our audit period and return the funds to the Department and lenders.

## UNIVERSITY'S COMMENTS TO THE DRAFT REPORT AND OIG'S RESPONSE

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

University's Comments. **The allocation of revenue under the IPD contract does not violate the Incentive Compensation Rule.** The University stated that:

- The IPD Contract compensates IPD based on the volume of a broad range of professional services provided to [the] University, many of which have variable costs dependant on the number of students enrolled in the Adult Studies programs.
- The Incentive Compensation Rule does not apply to the IPD Contract because (1) the Department is without legal authority to use the rule as a basis for regulating routine contracts for professional, non-enrollment related services; and (2) the rule cannot apply to service contracts where the cost of providing services necessarily varies depending on the number of students.
- The Department has published no regulation or other public guidance supporting the interpretation of revenue-sharing arrangements advanced by the OIG in the Draft Audit Report.

**The IPD Contract compensates IPD based on the volume of a broad range of professional services provided to the University.** The University stated that IPD provides the following list of services with respect to the operation of the Adult Studies programs:

- Management consultation and training regarding:
  - Program administration and evaluation;
  - Marketing research and planning;
  - Student accounts management and reporting;
  - Student tracking systems development and implementation;
  - Faculty recruitment and assessment;
  - Ongoing curriculum review and revision;
- Learning outcome assessments and academic quality control evaluations;
- Program administration, including office space, on-site contract manager, and support administration support staff;
- Professional development and training activities for the University's financial aid staff, student services personnel, and Adult Studies faculty;
- Feasibility Studies concerning potential expansion of Adult Studies programs.

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

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

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

The University does not dispute that the payments made to IPD were based on a percentage of the tuition and fees paid by students enrolled in the Adult Studies programs. Likewise, the University does not dispute that IPD was responsible for recruiting students. Nor does the University dispute that some portion of the amount paid to IPD was directly related to IPD's success in securing enrollments for the University's Adult Studies programs. Our audit report did not focus on what other services may have been provided by IPD because once IPD became

responsible for recruiting students, even among other activities, and received compensation from the University based on the number of students enrolled in the program, the University was in violation of the HEA.

The HEA at § 487(a)(20) states:

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

Once recruiting was added to the services to be provided under the contract, compensation based on enrollment was no longer permitted. IPD had sole responsibility for recruitment and enrollment, and was paid under the contract only on the basis of its success in securing student enrollment regardless of what other services it may have been providing. Whether or not the revenue allocation was intended to provide compensation for other services is irrelevant because the allocation violates the law.

University's Comments. **The Incentive Compensation Rule does not apply to the IPD Contract because (a) the Department has no legal authority for using the Incentive Compensation Rule as a basis for regulating routine contracts for professional, non-enrollment related services; and (b) the Incentive Compensation Rule cannot apply to service contracts where the cost of providing services necessarily varies depending on the number of students.** The University stated that the Incentive Compensation Rule was intended to prevent schools from using commissioned salespersons to recruit students, not to regulate business arrangements. When Congress enacted the statute, and the Department promulgated the implementing regulation, both emphasized their intention to halt the use of commissioned salespersons as recruiters.

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

University's Comments. **The Department has published no regulation or other public guidance supporting the OIG's interpretation of the Incentive Compensation Rule to restrict routine revenue sharing arrangements.** The University stated that the draft report cites no regulatory guidance, case law, or other published guidance to support the proposition that the revenue allocation formula violates the Incentive Compensation Rule. The University did not know, and could not have known, that the revenue allocation formula would be construed as a violation of the Incentive Compensation Rule, because no such pronouncement or interpretation had ever been published and disseminated to Title IV participating institutions.

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

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

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

University's Comments. **The OIG's recommendation – disallowance of all Title IV funds received by the University for all Adult Studies enrollees – is unwarranted and is inconsistent with applicable law and regulations.** The University stated that no basis exists to support that a violation of any of the innumerable requirements of the program participation agreement warrants a wholesale disallowance of all Title IV funds. In the absence of any OIG statement of reasons, or other detailed explanation for the extreme sanction, the University cannot presently submit any comprehensive response to the draft audit report's recommendations.

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

University's Comments. **Recruiter salaries do not violate the Incentive Compensation Rule because (1) the Incentive Compensation Rule does not prohibit salary based on success in securing enrollments; (2) the legislative history of the Incentive Compensation Rule makes clear that Congress intended to permit recruiter salaries to be based on merit; and (3) the Secretary has not published any interpretation of the Incentive Compensation Rule that would prohibit recruiter salaries based on merit.** The University stated that IPD's compensation plans based recruiter salaries on factors or qualities that are not solely related to success in securing enrollments. It also stated that the prohibition in §487(a)(20) did not extend to salaries. Even if salaries were included, the University stated that salaries could be based on merit or success in securing enrollment as long as enrollment was not the sole factor.

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

**Finding 2 – Non-Term Institutions Must Provide a Minimum of 360 Hours of Instructional Time in an Academic Year**

HEA § 481(a)(2) states that the term “academic year” shall:

Require a minimum of 30 weeks of instructional time, and, with respect to an undergraduate course of study, shall require that during such minimum period of instructional time a full-time student is expected to complete at least 24 semester or trimester hours or 36 quarter hours at an institution that measures program length in credit hours . . . .

The regulations at 34 C.F.R. § 668.2(b) clarify what constitutes a week of instructional time in the definition of an academic year:

. . . the Secretary considers a week of instructional time to be any week in which at least one day of regularly scheduled instruction, examinations, or preparation for examinations occurs . . . . For an educational program using credit hours but not using a semester, trimester, or quarter system, the Secretary considers a week of instructional time to be any week in which at least 12 hours of regularly scheduled instruction, examinations, or preparation for examinations occurs . . . .

These regulations, commonly known as the 12-Hour Rule, require the equivalent of 360 instructional hours per academic year (12 hours per week for 30 weeks). Institutions were required to comply with the 12-Hour Rule as of July 1, 1995.

In the preamble to the 12-Hour Rule regulations published on November 29, 1994, the Secretary explained that an institution with a program that meets less frequently than 12 hours per week would have to meet for a sufficient number of weeks to result in the required instructional hours. For example, if an institution decided to establish an academic year for a program with classes that met for 10 hours per week, the classes would need to be held for 36 weeks to result in 360 hours.

The University measured its Adult Studies education programs in credit hours, but did not use a semester, trimester, or quarter system. The Adult Studies programs consisted of a series of courses for which a student generally received three credit hours per course. The University defined its academic year as 45 weeks, during which students could earn 26 credit hours. To comply with the 12-Hour Rule, the University would need to provide at least eight hours of instruction per week for each week in its 45-week academic year to equal 360 hours per year.

### **The University Did Not Have Management Controls in Place to Ensure That the Required 360 Hours of Instruction for Each Academic Year Were Scheduled and Occurred**

Management controls are the policies and procedures adopted and implemented by an organization to ensure that it meets its goals, which, as applicable to this situation, are compliance with laws and regulations. According to the Adult Studies Student Handbook, students were required to meet in class for four hours per week, and were expected to meet an additional four hours per week in study groups. The Adult Studies Student Handbook stated: “[I]t is the policy of SWU AGS administrative staff not to interfere with the make-up or operation of any study group.” The University counted the study group time for purposes of the

12-Hour Rule. We found that the University did not establish and implement management controls to ensure that study groups were regularly scheduled and occurred.

We reviewed the University's policies applicable to the Adult Studies program classes and study groups. The Adult Studies Handbook provided that class attendance was mandatory, with a student missing more than 25 percent of the classes receiving no credit for the course. The Adult Studies Handbook had no such provision for study group participation and instructors were not required to be present at study group meetings. According to the Adult Studies Handbook, each study group was required to create a study group "constitution" to govern the operation of the group and to "help ensure fairness and equality in the outcomes of group processing." The constitution was designed to show (1) the time and place for each group meeting and (2) the students' agreement to comply with the rules and expectations of the University. University officials stated that study group constitutions were graded by professors and returned to the students, and that the constitutions did not become part of the students' permanent records. Therefore, the constitutions were unavailable for our review.

Our review of the University's records showed that not all study groups met for the required number of hours. Each cohort group (class) ranged in size from 16 to 22 students, and each cohort group had about 4 to 5 study groups, each of which consisted of 3 to 5 students. At the time of our fieldwork, the University had 79 study groups. We selected a sample of six classes (two from each of the three years in our audit period), and then requested study group meeting logs for those classes. The documentation that we obtained identified 81 courses for those six classes. At the time of our fieldwork, 10 of the courses had not been completed. The students in the remaining 71 courses should have met in a total of at least 1,520 study group sessions. We determined that the University did not have evidence to support that 54 percent of the required 6,080 study group hours for the 1,520 study group sessions were regularly scheduled and occurred.

Based on our review of the University's written policies and procedures, review of academic records, and interviews with University officials, the University had no assurance that study groups were scheduled and occurred to meet the requirements of the 12-Hour Rule.

### **Failing to Comply with the 12-Hour Rule Resulted in the University Over Awarding \$4,768,997 of Title IV Funds to Students Enrolled in the Adult Studies Programs**

Because the University did not ensure that study group meetings were scheduled and occurred as required, the meetings do not qualify for inclusion in the 12-Hour Rule calculation.

Consequently, the University's defined academic year of 45 weeks provided only 180 hours of the required minimum of 360 hours of instructional time (four hours of classroom instruction per week for 45 weeks equals 180 hours). In order to meet the 360-hour requirement, the University's academic year would need to be 90 weeks in length. By using an academic year of 45 weeks rather than 90 weeks for awarding Title IV funds, the University disbursed amounts to students that exceeded the maximum amounts for an academic year allowed under Title IV programs. We estimated that the University over awarded \$4,768,997 of Title IV funds for Adult Studies students during the period July 1, 1997, through June 30, 2000. Those funds consisted of \$4,229,215 in FFEL and \$539,782 in Pell.

**FFEL Limits** - 34 C.F.R. § 682.603(d) stipulates that an institution may not certify a loan application that would result in a borrower exceeding the maximum annual loan amounts specified in 34 C.F.R. § 682.204. We estimated that \$4,229,215 in FFEL disbursements exceeded the annual loan limits.

**Pell Grant Maximum** - 34 C.F.R. § 690.62(a) specifies that the amount of a student's Pell Grant for an academic year is based upon schedules published by the Secretary for each award year. The payment schedule lists the maximum amount a student could receive during a full academic year. We estimated that \$539,782 in Pell Grant disbursements exceeded the maximum amount allowed.

Institutions were required to comply with the 12-Hour Rule as of July 1, 1995. Because the University's academic year for its Adult Studies programs did not meet the requirements of the 12-Hour Rule, the University improperly disbursed Title IV funds awarded during the audit period.

## RECOMMENDATION

We recommend that the Chief Operating Officer for FSA require the University to:

- 2.1. Immediately develop an academic year for its undergraduate Adult Studies programs that satisfies the 12-Hour Rule as a condition for continued participation in Title IV programs.

The dollars we estimated as over awarded due to violating the statutory course length requirements are duplicative of the dollars we determined as over awarded due to violating the statutory prohibition against the use of incentive payments for recruiting activities. Only those amounts not recovered in Finding 1 should be recovered by FSA as a result of Finding 2.

## UNIVERSITY'S COMMENTS TO THE DRAFT REPORT AND OIG'S RESPONSE

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

In summary, the University stated that:

- I. The Adult Studies program complies with the 12-Hour Rule, and the University has adequately documented its compliance with the 12-Hour Rule.
  - A. Study group meetings constitute instructional activity.
  - B. The University implemented pre-enrollment procedures to ensure students' awareness of the study group attendance requirements.

- C. Study group meetings were regularly scheduled and closely monitored by the University.
  - D. Study groups are part of an integrated curriculum module, and faculty members were aware of which students did not attend the study group meetings in any given week.
  - E. Additional hours spent by students in preparation for examinations are includable under the 12-Hour Rule.
  - F. There is no statutory or regulatory basis for the OIG's requirement that the University "ensure that study group meetings were taking place."
- II. The 12-Hour Rule is widely acknowledged to be unworkable and ill-suited for nontraditional programs.
  - III. The recommended liability is based on erroneous methodology and excludes significant amounts of time that can count toward compliance with the 12-Hour Rule.

**University's Comments. The University's Adult Studies program complies with the 12-Hour Rule and the University has adequately documented its compliance with the 12-Hour Rule.**

The University stated that the fact that it could document that 46 percent of the study groups occurred demonstrated its diligence in applying multiple layers of monitoring controls to study groups. It also questioned why we did not give the University credit for the study groups it could document in determining the amount of Title IV funds that were overawarded.

The University stated that the Department has already concluded that "[t] here is no meaningful way to measure 12 hours of instruction" for nontraditional education programs like those questioned by the draft audit report. The University implemented various policies and procedures to ensure the Adult Studies programs provided the requisite amount of regularly scheduled instruction, examinations, or preparation for examinations required by the 12-Hour Rule. The University also stated that the OIG had established a *documentation rule* that exceeded statutory and regulatory requirements.

**OIG's Response.** It is the University's responsibility to provide each full-time student with 360 hours of regularly scheduled instruction. It is a simple matter to demonstrate compliance with the requirement when dealing with classroom instruction because institutions need to plan for and reserve the space for classes as well as arrange for and pay an instructor. The University did not schedule space for study groups or provide an instructor for students at other than the scheduled classroom time. It is the University's responsibility to demonstrate compliance with the Title IV regulations. The University could not provide us with any documentation that the study groups were regularly scheduled. What the University did provide supported less than half the required number of additional hours from study groups. This did not give us sufficient evidence to conclude that the study groups were regularly scheduled and occurred.

The *Report to Congress on the Distance Education Demonstration Programs* quoted by the University refers to distance education classes that allow students to move at their own pace. Students in the Adult Studies program were required to attend weekly study group meetings,

which the University did not consider as homework. The following excerpt from the report expands the quotation provided by the University to include additional clarifying information.

It is difficult if not impossible for distance education programs offered in nonstandard terms and non-terms to comply with the 12-hour rule. The regulation would seem to require that full-time distance education students spend 12 hours per week “receiving” instruction. There is no meaningful way to measure 12 hours of instruction in a distance education class. Distance education courses are typically structured in modules that combine both what [sic] an on-site course might be considered instruction and out-of-class work, so there is no distinction between instructional time and [d] ‘homework.’ In addition, when they are given the flexibility to move at their own pace, some students will take a shorter time to master the material, while others might take longer.

On August 10, 2000, the Department issued a Notice of Proposed Rulemaking (NPRM) concerning, among other items, changes to the 12-Hour Rule. In the NPRM, the Department stated, “[i]t was never intended that homework should count as instructional time in determining whether a program meets the definition of an academic year, since the 12-hour rule was designed to quantify the in-class component of an academic program.”

We have not established a documentation rule. An institution participating in the Title IV, HEA programs is required to establish and maintain on a current basis records that document the eligibility of its programs and its administration of the Title IV programs in accordance with all applicable requirements (34 C.F.R. § 668.24(a)). Our audit procedures included reviewing any documentation that demonstrated the University’s compliance with the 12-Hour Rule. We did not *require* any specific documentation as part of our audit. We found that the available documentation and the University’s internal control system did not support a conclusion that the University complied with the 12-Hour Rule.

University’s Comments. **Study group meetings constitute instructional activity.** The University stated that study group meetings fall within the scope of “regularly scheduled instruction, examinations, or preparation for examinations.” The study group meetings clearly relate to class preparation, and the regulations imply that activities relating to class preparation qualify as instructional time.

OIG’s Response. We determined that the University did not establish and implement adequate internal controls to ensure that study group meetings were actually scheduled and occurred as required by the University. On August 10, 2000, the Department issued an NPRM concerning, among other items, changes to the 12-Hour Rule. In the NPRM, the Department stated, “[i]t was never intended that homework should count as instructional time in determining whether a program meets the definition of an academic year, since the 12-hour rule was designed to quantify the in-class component of an academic program.”

University’s Comments. **The University implemented pre-enrollment procedures to ensure students’ awareness of the study group attendance requirements. Study group meetings were regularly scheduled and closely monitored by the University.** The University required

students to attend study group meetings in order to discuss course material, prepare graded assignments, and share learning resources. Each student was expected to contribute to the completion of all study group assignments, which included oral and written presentations. The University repeatedly informed students that attendance in the study groups was mandatory and played a critical role in the overall education program. The students, in the first week of the program, completed a “Study Group Constitution” listing the names of all group members, and stating the day, time, and location of their weekly study group meeting. Each study group submitted its Constitution to a faculty member, who reviewed whether the proposed meeting location and time were conducive to learning.

Several other factors indicate the study group meetings were “regular,” “scheduled,” and under the supervision of University faculty. Specific tasks were specified in the course module, and all students enrolled in the course were required to participate in study group activities. During study group meetings, students completed rigorous team assignments, often preparing specified projects that were presented during the next faculty-led workshop. The faculty exerted control over the study group meetings by reviewing and grading the designated team assignments and projects.

OIG’s Response. While the University stated that the Study Group Constitutions listed the day, time, and location of its weekly study group meetings, it did not provide us with these constitutions during our fieldwork or with its response. We agree that the course modules spelled out the requirements for study group assignments as the University has stated. However, we disagree that a record of graded assignments supports a conclusion that study group meetings were regularly scheduled for the required number of hours. On August 10, 2000, the Department issued an NPRM concerning, among other items, changes to the 12-Hour Rule. In the NPRM, the Department stated, “[i]t was never intended that homework should count as instructional time in determining whether a program meets the definition of an academic year, since the 12-hour rule was designed to quantify the in-class component of an academic program.

University’s Comments. **Study groups are part of an integrated curriculum module, and faculty members were aware of which students did not attend the study group meetings in any given week.** The University contends the OIG’s position is that an instructor must be present at study group meetings in order for study groups to count as instructional time under the 12-Hour Rule. The 12-Hour Rule expressly states that time spent in preparation for examinations is included in the overall calculation of instructional activity. Faculty presence is not required when students prepare for examinations, nor is it required for the faculty member to assess whether a student adequately participated in the weekly meetings because the required work is reviewed and graded.

OIG’s Response. Our objective was to determine whether the University complied with the requirements of the 12-Hour Rule. The University defined its academic year to comply with the 12-Hour Rule, and this definition required that students attend four hours per week in study groups. Any time that students spent in preparation for examinations outside of study groups was not applicable to our review. Our determination that an instructor was not present at study group meetings was a result of our review of the University’s overall internal control over study

groups. If an instructor had been present at study group meetings, we would have considered this as evidence of strong control.

**University's Comments. Additional hours spent by students in preparation for examinations is includable under the 12-Hour Rule.** Some Adult Studies courses utilize traditional examinations, in addition to study group presentations and other graded activities. The draft audit report ignores the additional hours spent by students in those courses preparing for examinations, although the 12-Hour Rule explicitly permits time spent in preparation for examinations to be counted towards compliance.

**OIG's Response.** The University defined its academic year as consisting of 8 hours of instruction per week for 45 weeks. This definition provided the *minimum* 360 hours of instruction as required by the 12-Hour Rule. University policy required that 4 hours per week be spent in classroom workshops and 4 hours per week be spent in study group meetings. Whether or not students spent additional time preparing for exams is not relevant to the University's definition of an academic year. On August 10, 2000, the Department issued an NPRM concerning, among other items, changes to the 12-Hour Rule. The Department stated that "the only time spent in 'preparation for exams' that could count as instructional time was the preparation time that some institutions schedule as study days in lieu of scheduled classes between the end of formal class work and the beginning of final exams." The Adult Studies program had no study days scheduled in lieu of scheduled classes.

**University's Comments. There is no statutory or regulatory requirement for the OIG's requirements that the University "ensure that study group meetings were taking place."** The University stated there is no legal authority for the statement in the draft audit report that the University must "ensure" that study groups actually "occurred." All the 12-Hour Rule requires is that study group meetings were regularly scheduled. The more reasonable interpretation, tracking actual text of the regulation, is consistent with the amendments to the 12-Hour Rule that took effect July 1, 2001. The revised 12-Hour Rule requires an institution to provide "[a]t least 12 hours of regularly scheduled instruction or examination" or "[a]fter the last scheduled day of classes for a payment period, at least 12 hours of study for final examinations." 34 C.F.R. § 668.2(b)(2) (2001). The regulation does not require the minimum 12 hours of study, after the last day of classes, to occur under direct faculty supervision or for the University to somehow document that each and every student actually studied at least 12 hours during the period between classes and exams. This revision makes clear that the focus of the rule, both before and after the regulatory change, is on whether instructional time is "regularly scheduled" and not on whether an institution can document that students actually completed 12 hours of instructional activity in any given week.

**OIG's Response.** The University's assertion that there is no requirement that it ensure the study group meetings actually occurred is not correct. As a fiduciary, the University must exercise, in accordance with 34 C.F.R. § 668.82(a), the highest standard of care and diligence in administering the Title IV programs, including compliance with the 12-Hour Rule. In addition, the regulations at 34 C.F.R. § 668.24(a)(3) provide that the institution must "establish and maintain on a current basis . . . program records that document . . . [i]ts administration of the Title IV, HEA programs in accordance with all applicable requirements." The University must ensure

that the study groups occur in order to confirm the validity of the schedule, the hours assigned, and the amounts of Title IV disbursed for those meetings. If the study groups did not meet as supposedly scheduled, then the University would be disbursing Title IV funds on the basis of instructional hours that it does not in fact provide.

Contrary to the University's assertion, we are not attempting to establish a requirement to document every hour of student attendance. We examined whether the study group meetings occurred in order to corroborate compliance with the 12-Hour Rule. Evidence of attendance, if it existed, would help support a conclusion that the study group meetings were regularly scheduled and that the study group hours supported the amount of Title IV aid disbursed. We reviewed the student and faculty handbooks, and we held discussions with University officials to obtain an understanding of the University's policies and procedures as they related to its attendance policy. The University's own policy was that study group attendance was to be monitored. University officials could not provide us with evidence to show this was actually done. In the absence of study group attendance reports or some other effective control selected by the University, we have no basis to conclude that the University adequately monitored study group meeting occurrence or compliance with the 12-Hour Rule.

University's Comments. **The 12-Hour Rule is widely acknowledged to be unworkable and ill-suited for nontraditional education programs.** The University stated that the underlying basis for the 12-Hour Rule and its continued applicability to the Title IV programs are presently in serious doubt. The HEA requires a minimum of 30 weeks of instructional time; however, the 12-hour per week requirement was added by regulation and therefore does not have any statutory basis. The appropriateness of the 12-Hour Rule, and the immeasurable burden it has created for institutions, has recently come under increased scrutiny. In addition, the Internet Equity and Education Act of 2001, adopted by the House of Representatives Committee on Education and the Workforce, effectively eliminates the 12-Hour Rule.

OIG's Response. The University was required to comply with the HEA and the regulations in effect during our audit period. The 12-Hour Rule was a regulatory complement to the statutory definition of an academic year, and the University acknowledged it was required to comply with it. As with any other regulation, the University must be able to document that it is in compliance. Accordingly, the University must be able to document that its academic year provided 360 hours of instruction for full-time students.

University's Comments. **The recommended liability is based on an erroneous methodology and excludes significant amounts of time that count toward compliance with the 12-Hour Rule.** The OIG fails to consider instructional activity includable under the 12-Hour Rule occurs outside of the classroom and study group meetings. Students' grades are determined through traditional examinations, graded individual presentations and papers, graded group projects, or a combination thereof. No legal authority requires the time spent on these activities to be monitored or measured under the 12-Hour Rule, but it must be assumed that students spent additional time preparing for these examinations and graded activities.

OIG's Response. The University defined its academic year as consisting of a minimum of four hours per week in classroom workshops, and four hours per week in study group meetings. If

individual students spent additional time in preparation for examinations or homework-type activities, it would not be relevant to the University's compliance with the 12-Hour Rule. Students were *required* to spend four hours per week in study *group* meetings. As previously noted, the Department has stated that "[i]t was never intended that homework should count as instructional time in determining whether a program meets the definition of an academic year, since the 12-hour rule was designed to quantify the in-class component of an academic program."

## **BACKGROUND**

Founded by The Wesleyan Church in 1906, the University is a liberal arts institution located in the town of Central, South Carolina. The University also conducts classes in several other locations within the State of South Carolina. The Southern Association of Colleges and Schools (SACS) accredits the institution to offer associate, bachelor's, and master's degrees. Undergraduate programs are offered in business and in management. Graduate programs are offered in ministry and in management. Prior to our audit period, the University founded the Leadership Education for Adult Professionals (LEAP) program to meet the needs of adult students. Effective in 1998-1999, it combined the LEAP program with other programs to form the Adult and Graduate Studies (Adult Studies) programs.

In March 1986, the University contracted with IPD, a subsidiary of the Apollo Group, Inc., to help improve its Adult Studies programs. The University contracted with IPD for marketing, recruiting, and accounting support, while it provided the curriculum, facilities, and faculty. During the audit period, the University and IPD shared tuition revenue, but the University received 100 percent of book, material, computer, and other miscellaneous fees.

During the period July 1, 1997, through June 30, 2000, the University participated in the FFEL, Pell, FSEOG, and Perkins programs. The University's records indicated that, during the period, the University or lenders disbursed \$19,451,123 on behalf of students in the Adult Studies programs. That amount specifically consisted of \$18,346,658 in FFEL, \$1,079,565 in Pell, \$21,400 in FSEOG, and \$3,500 in Perkins.

Title IV of the HEA of 1965, as amended, authorizes these programs, and they are governed by regulations contained in 34 C.F.R. Parts 676, 682, and 690, respectively. In addition, these programs are subject to the provisions contained in the Student Assistance General Provisions regulations (34 C.F.R. Part 668), and the University must comply with the Institutional Eligibility regulations (34 C.F.R. Part 600) to participate in these programs. Regulatory citations in the report are to the codifications revised as of July 1, 1997, 1998, and 1999.

## **OBJECTIVES, SCOPE, AND METHODOLOGY**

The objectives of the audit were to determine whether the University complied with the HEA's prohibition against the use of incentive payments for recruiting activities and with the HEA's required minimum number of instructional hours. We specifically focused our review on the

University's contract with IPD, the programs of study related to that contract, and the area of required hours of instruction in an academic year under the 12-Hour Rule.

To accomplish our objectives, we reviewed the University's policies and procedures, accounting and bank records, and student financial assistance records. We reviewed the University's Program Participation Agreement with the Department, its contract with IPD, and IPD's compensation plans for its recruiters. In addition, we reviewed Single Audit reports prepared by the University's Certified Public Accountants and a program review report prepared by FSA. We also reviewed a report issued by the University's accrediting agency.

We relied on computer-processed data that the University extracted from its financial assistance database and on computer-processed data that IPD extracted from its financial assistance database. We assessed the reliability of the data by comparing University and IPD records for total disbursements and also by comparing records from those two sources for selected student disbursements. We concluded that the data provided by the University was sufficiently reliable to use in meeting the audit's objectives.

The audit covered the period July 1, 1997, through June 30, 2000. We performed on-site fieldwork at the University's main location in Central, South Carolina during the periods September 12-21, 2000, and October 18, 2000. We held a field exit conference on October 18, 2000. On December 4, 2001, we notified the University that we were assessing a liability for the 12-Hour Rule finding. On December 20, 2001, we requested additional information from the University. On January 18, 2002, the University informed us that the information was not available. We issued a draft report to the University on April 18, 2002, and the University responded to our report on June 17, 2002. We conducted the audit in accordance with generally accepted government auditing standards appropriate to the scope of audit described above.

### **Methodology Used to Determine the Title IV Funds Improperly Disbursed for Finding 2**

Students were required to meet in class for four hours per week, and were expected to meet an additional four hours per week in study groups. The University counted the study group time for purposes of the 12-Hour Rule. Therefore, we reviewed the University's records to determine whether the study groups met for the required number of hours. Each cohort group (class) ranged in size from 16 to 22 students, and each cohort group had about 4 to 5 study groups, each of which consisted of 3 to 5 students. At the time of our fieldwork, the University had 79 study groups. We selected a sample of six classes (two from each of the three years in our audit period), and then requested study group documentation (attendance logs) for those classes. The documentation that we obtained identified 81 courses for those six classes. At the time of our fieldwork, 10 of the courses had not been completed. The students in the remaining 71 courses should have met in a total of at least 1,520 study group sessions. We reviewed a total of 180 study group meeting logs to determine the amount of recorded study group attendance.

The University's academic year would need to be 90 weeks in length for it to meet the 360-hour requirement for an academic year. Therefore, the University could not (1) disburse Title IV funds to students during a 90-week academic period that exceeded the maximum annual amounts

for an academic year allowed under the FFEL and Pell programs and (2) disburse FFEL funds to students who were enrolled less than half-time during a 90-week academic period.

#### FFEL Disbursements in Excess of Annual Limits

We compared the disbursements to the applicable annual loan limit. Students were not eligible to receive the amounts that exceeded the limit. For the two groups described below, we estimated \$4,229,215 of disbursements that exceeded the annual limits.

For the FFEL estimates, we analyzed disbursements for two separate groups of students identified from the University-provided files. For students in each group, we analyzed loan period start dates and the loan disbursements covering a 90-week academic period.

The first group consisted of students who received disbursements for **loans with loan start dates** in the period July 1, 1997, through June 30, 1998 **and** disbursements for **loans with loan start dates** in the period July 1, 1998, through June 30, 1999.

The second group, which excludes students included in the first group, consisted of students who received disbursements for **loans with loan start dates** in the period July 1, 1998, through June 30, 1999 **and** disbursements for **loans with loan start dates** in the period July 1, 1999, through June 30, 2000.

#### Pell Disbursements in Excess of Annual Limits

We identified the Pell funds disbursed to students for our three-year audit period (July 1, 1997, through June 30, 2000). To determine the amount of Pell funds that a student may receive in a payment period, institutions without standard terms multiply the maximum amount shown on schedules published by the Secretary by a specified fraction. The numerator of the fraction is the number of credit hours in a payment period and the denominator is the number of credit hours in an academic year. Because the University used the credit hours for a 45-week academic year rather than a 90-week academic year as the denominator, the Pell awards disbursed were double the amounts that should have been disbursed. We estimated \$539,782 in Pell disbursements exceeded the maximum amount allowed.

## **STATEMENT ON MANAGEMENT CONTROLS**

As part of our review, we gained an understanding of the University's management control structure, as well as its policies, procedures, and practices applicable to the scope of the audit. Our purpose was to assess the level of control risk for determining the nature, extent, and timing of our substantive tests. We assessed the subject of course length as a significant control.

Due to inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in the management controls. However, our assessment disclosed significant management control weaknesses that adversely affected the University's ability to administer Title IV programs. Those weaknesses included incentive-

based payments for student enrollment that violated the statutory prohibition against commissioned sales and inadequate control over the amount of time spent in instruction that violated the requirements of the HEA and the regulations. The Audit Results section of this report fully discusses those weaknesses and their effects.

### **ADMINISTRATIVE MATTERS**

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

James Manning, Acting Chief Operating Officer  
Federal Student Aid  
Regional Office Building, 7<sup>th</sup> and D Streets, S.W.  
ROB Room 4004, Mail Stop 5132  
Washington, DC 20202

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

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

If you have any questions or wish to discuss the contents of this report, please call Sherri Demmel, Regional Inspector General for Audit, Dallas, Texas at (214) 880-3031. Please refer to the control number in all correspondence related to the report.

Sincerely,

  
Thomas A. Carter  
Assistant Inspector General  
for Audit Services

Enclosure

**SOUTHERN  
WESLEYAN  
UNIVERSITY**

**Enclosure**

**OFFICE OF THE PRESIDENT**

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June 17, 2002

Ms. Sherri L. Demmel  
Regional Inspector General for Audit  
U.S. Department of Education  
Office of Inspector General  
1999 Bryan Street, Suite 2630  
Dallas, TX 75201-6817

**RE: Draft Audit Report; Southern Wesleyan University  
(Control Number ED-OIG/A06-A0024)**

Dear Ms. Demmel:

Attached please find Southern Wesleyan University's response to the Draft Audit Report issued on April 18, 2002 by the United States Department of Education, Office of Inspector General, Division of Audit. For all of the reasons presented therein, the University does not concur with the Findings and Recommendations set forth in the Draft Report.

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

Respectfully submitted,

  
David J. Spittal  
President

Attachment

**SOUTHERN WESLEYAN UNIVERSITY'S RESPONSE TO THE  
DRAFT AUDIT REPORT OF THE U.S. DEPARTMENT OF EDUCATION OFFICE OF  
INSPECTOR GENERAL (Control Number ED-OIG/A06-A0024)**

Southern Wesleyan University (the "University," or "SWU") is a private, not-for-profit, Christian liberal arts institution located in Central, South Carolina. Founded in 1906 by the Wesleyan Church, and known as Central Wesleyan College until 1995, the University's fall 2002 enrollment consisted of over 2100 students from 24 states and eight foreign countries. The University is accredited by the Commission on Colleges of the Southern Association of Colleges and Schools, and the National Association of State Directors of Teacher Education and Certification. SWU has consistently maintained low cohort default rates: 6.1 percent in Fiscal Year ("FY") 1999, 5.9 percent in FY 1998, and 2.5 percent in FY 1997.

The Draft Audit Report by the Office of Inspector General ("OIG") focuses upon federal student financial aid funds ("Title IV funds") received by students enrolled in SWU's Adult and Graduate Studies ("AGS") programs for working adults.<sup>1</sup> The University maintains a contract with an independent outside entity, the Institute for Professional Development ("IPD") for various services related to the AGS programs. The issues raised by the Draft Audit Report pertain both to the "Agreement between Southern Wesleyan University and Institute for Professional Development" (the "IPD Contract"), and to the structure of AGS courses. The AGS programs use a "cohort model" of learning in which small groups of students progress together through the academic program on a course-by-course basis. The curriculum relies on peer-based learning teams, in-class instruction, individual projects and group activities. All AGS courses are offered in a structured sequence with students completing one course at a time, allowing complete focus in each topic area.

The Draft Audit Report first erroneously claims that the University "was not in compliance with the statutory prohibition on the use of incentive payments" (the "Incentive Compensation Rule") when it contracted with IPD. Draft Audit Report at 1, 3. Based on this conclusion, the OIG recommends that the U.S. Department of Education (the "Department" or "ED") require the University to return all Title IV funds disbursed for the AGS programs between July 1, 1997 and June 30, 2000. The Draft Audit Report further claims, despite probative evidence that SWU monitored study groups in a variety of methods, that the University could not adequately document that its [AGS] programs provided the number of instructional hours required under the so-called 12-Hour Rule. *Id.* Following this conclusion, the OIG *incorrectly asserts that the University overawarded Title IV funds to AGS students.*<sup>2</sup> Draft Audit Report at 1, 5. The University strenuously disagrees with both of these findings and the OIG's recommendations, for the reasons set forth herein.

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<sup>1</sup> The Adult and Graduate Studies program was previously called the Leadership Education for Adult Professionals ("LEAP") program. This response shall refer to the program by its current name only.

<sup>2</sup> As the Draft Audit Report notes on page 7, the Title IV funds at issue under the 12-Hour Rule finding are duplicative of amounts covered by the Incentive Compensation Rule issue.

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**I. NEITHER SOUTHERN WESLEYAN UNIVERSITY NOR THE INSTITUTE FOR PROFESSIONAL DEVELOPMENT VIOLATED THE INCENTIVE COMPENSATION RULE.**

The University disagrees with the Draft Audit Report's assertion that the IPD Contract's revenue allocation provisions violate the Incentive Compensation Rule. In addition, the OIG's recommendation that the University return all Title IV funding disbursed for the AGS programs is an extreme, unjustified, and arbitrarily proposed sanction without support in applicable law or regulations. Finally, IPD maintains that its recruiter salaries do not violate the Incentive Compensation Rule.

**A. The Allocation of Revenue Under the IPD Contract Does Not Violate the Incentive Compensation Rule.**

The Draft Audit Report erroneously claims that the revenue allocation provision of the IPD Contract is prohibited. This claim is based on the OIG's allegation that the University was "paying incentives to IPD based on success in securing student enrollments for its [AGS] programs." Draft Audit Report at 3. The University vigorously disagrees with both the draft finding and recommendation, for each of the following reasons:

- The IPD Contract compensates IPD based on the volume of a broad range of professional services provided to the University, many of which have variable costs dependant on the number of students enrolled in the AGS programs.
- The Incentive Compensation Rule does not apply to the IPD Contract because (1) the Department is without legal authority to use the rule as a basis for regulating routine contracts for professional, non-enrollment related services; and (2) the rule cannot apply to service contracts where the cost of providing services necessarily varies depending on the number of students.
- The Department has published no regulation or other public guidance supporting the interpretation of revenue-sharing agreements advanced by the OIG in the Draft Audit Report. Indeed, the only public pronouncement from the Department related to revenue-sharing is directly contrary to the position of the OIG.

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

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

In the present case, IPD performed the following broad range of non-recruitment and non-enrollment services, all of which are not specifically referenced in the IPD Contract but nonetheless occurred pursuant to the contract, at IPD's expense, regarding the operation of the AGS programs:

- Management consulting and training regarding:
  - Program administration and evaluation;
  - Marketing research and planning;
  - Student accounts management and reporting;
  - Student tracking systems development and implementation;
  - Faculty recruitment and assessment;
  - Ongoing curriculum review and revision;
- Learning outcome assessments and academic quality control evaluations;
- Program administration, including office space, on-site contract manager, and support administrative support staff;
- Professional development and training activities for University's financial aid staff, student services personnel, and AGS faculty;
- Feasibility studies concerning potential expansion of AGS programs.

The OIG ignores the many non-enrollment related services performed by IPD under the contract, and instead treats the contract as if it covered only recruitment and student accounting functions. See Draft Audit Report at pages 2-3. The OIG wrongly implies that recruitment and tuition collections constituted IPD's only functions with respect to the AGS programs, id., when in fact IPD performed many and varied functions other than recruitment under its contract with the University, all of which are essential to the success of the programs. In addition, the OIG ignores the fact that the overall cost to any vendor of providing many of the above services is highly dependent on the volume required, which is, in turn, dependent on the numbers of students at the institution. The IPD Contract therefore simply allocates revenues to reimburse IPD for additional services provided to the University as its demand for services increases.

Based on an erroneously narrow view of IPD's responsibilities and a summary rejection of the somewhat obvious concept that additional AGS students create additional expenses, the Draft Audit Report incorrectly concludes that any amounts paid by the University to IPD were in consideration for "securing student enrollments for its [AGS] programs," and for no other functions whatsoever. Id. The IPD Contract, however, reflects that the allocation of AGS tuition revenues is based upon a wide range of non-enrollment related academic and administration

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functions, in addition to the limited items identified in the Draft Audit Report. If the OIG auditors unintentionally overlooked these additional IPD responsibilities in the course of their review, the audit procedures were incomplete and therefore flawed. However, if the auditors were aware of these additional IPD services and chose to ignore them, the Draft Audit Report is flawed in a manner that raises questions about the impartiality of the audit process.

Beyond its failure to examine the broad range of IPD's non-enrollment related academic and administrative functions, the Draft Audit Report's reliance upon certain marketing-oriented functions similarly fails to demonstrate any violation of the Incentive Compensation Rule. IPD had no authority or control with respect to the University's criteria, standards, procedures or decisions respecting the admission or enrollment of students. Moreover, it was the University, and not IPD, that awarded Title IV funds to those AGS students participating in the federal student financial aid programs. Accordingly, IPD did not and could not secure enrollments within the meaning of the Incentive Compensation Rule. The Rule's prohibition extends solely with respect to payments based upon "success in securing enrollments or financial aid." The prohibition therefore does not apply to IPD, which could not and did not secure enrollments or financial aid for the University.

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

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

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

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

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

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

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

34 C.F.R. § 668.14(b)(22). It is plain from the express language of both provisions that the Incentive Compensation Rule was intended to prevent schools from using commissioned salespersons to recruit students, not to regulate business arrangements such as the one described in the Draft Audit Report, which pay for a wide array of professional services based on the volume of services received by a higher education institution. The legislative and regulatory histories clearly emphasize the intent to halt the use of commissioned salespersons as recruiters. Congress explained:

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

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

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

59 Fed. Reg. 9539 (February 28, 1994). There is simply nothing in either legislative or regulatory history to support the Incentive Compensation Rule as a basis for the Department to regulate institutions' routine business arrangements with outside vendors where services are contracted for at a set rate of compensation based on the volume of services provided, such as the contract between SWU and IPD.<sup>3</sup>

- b. The Incentive Compensation Rule cannot apply to service contracts where the cost of providing services necessarily varies depending on the number of students.

The array of professional services delineated in the IPD Contract, and performed accordingly, demonstrates that the partial allocation of revenues to IPD does not constitute incentive compensation attributable to enrollments, but instead is simply an equitable payment mechanism designed to account for the amount of work required of IPD in serving AGS students.

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<sup>3</sup> Notably, in contrast to the regulations later promulgated by ED, section 487(a) of the HEA makes no reference to contracts between educational institutions and outside entities.

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The magnitude of IPD's various functions and obligations under the contract depends in substantial part upon how many students enroll in the AGS programs. Indeed, many of the tasks assigned to IPD by the IPD Contract are highly volume sensitive. Because the parties could not predict how many students would enroll, they similarly could not predict how much work the IPD contract would entail. To account for this uncertainty in their business arrangement, the IPD Contract allocates revenue in a manner that compensates IPD on a basis roughly parallel to the scope and quantity of the required services. IPD's compensation is premised on the full scope of work to be performed for the University, not on IPD's success in enrolling any students in the AGS programs.

In contrast, the OIG would apparently disallow any payment arrangement between an institution and professional service provider that reflects indefinite quantities. This interpretation is flawed because the Incentive Compensation Rule applies to individual employees with a finite amount of time in which to perform job functions. However, for a professional services vendor that will employ more people and buy more resources to meet demand or increase productivity, there is no finite time resource as there is with individual employees. Therefore, if a vendor expands the level of services under a contract where demand is increasing, as in this case, providing the vendor with more total compensation to offset the greater workload and need for more employees is not a "bonus" but rather an equitable compensation for services rendered. These economic precepts dictate that the Incentive Compensation Rule can apply only to the compensation of individuals employed by the institution or the vendor. The rule cannot apply to payments made by an institution to a vendor for professional services rendered pursuant to contracts of indefinite quantities.<sup>4</sup>

The Draft Audit Report promotes a strained and unwarranted extension of the scope and meaning of the Incentive Compensation Rule far beyond its meaning and intent. Congress sought to impose a ban on the use of commissioned salespersons or "bounty hunters" that secured unqualified enrollments to procure unwarranted financial aid dollars for their employers. In stark contrast, this case involves total compensation that was calculated and paid based upon the quantity of professional and administrative services performed by a third-party contractor that exercised no control over eligibility for admissions or enrollment. Indeed, the act of recruitment at Southern Wesleyan University, whether by IPD for the AGS programs or by others for the remainder of the University, is not tantamount to enrollment. Therefore, this equitable business arrangement clearly does not fall within the scope of conduct prohibited by the statutory text or legislative intent, the regulation or any other public pronouncement by the Department. In

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<sup>4</sup>The OIG's interpretation creates a situation whereby small or medium sized institutions cannot contract with outside vendors to assist with developing innovative non-traditional educational delivery systems. Only larger institutions, with far more resources and internal capacity, will be able to effectively offer non-traditional programs of high quality.

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addition, the University's consistently low default rates are conclusive proof that the University does not admit unqualified students into its AGS programs. The Incentive Compensation Rule has absolutely nothing to do with the parties' revenue-sharing agreement, and the finding should be rescinded.

3. The Department has published no regulation or other public guidance supporting the OIG's interpretation of the Incentive Compensation Rule to restrict routine revenue sharing arrangements, and in fact the Department's only public pronouncement on this issue is directly contrary to the OIG's position.

The Draft Audit Report cites no case precedent, regulatory or non-regulatory guidance, or other legal authority to support the proposition that the allocation of revenue under the IPD Contract violates the Incentive Compensation Rule. This attempt by the OIG to create and retroactively apply a new requirement to SWU raises serious due process concerns. Namely, parties that are regulated by the Department, or by any other administrative agency, are entitled to adequate notice of what rules are to be applied to them. In this case, the University did not know, and could not have known, that the allocation of revenue in the IPD Contract would be construed as a violation of the Incentive Compensation Rule, because no such pronouncement or interpretation had ever been published and disseminated to Title IV-participating institutions.<sup>5</sup> Indeed, for all of the reasons presented in this submission, this University and many others like it reasonably believed the opposite.<sup>6</sup> And in fact, as discussed below, the Department's recent statements during negotiated rulemaking verify the University's reasonable belief.<sup>7</sup> We further submit that the interpretation advanced by the OIG in the Draft Audit Report is so removed from a reasonable person's understanding of the regulations that the University cannot be deemed to

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<sup>5</sup> For several months prior to the issuance of the Draft Audit Report, Department officials made frequent public statements that new non-regulatory guidance was imminent. However, in a letter dated August 2, 2001, Mr. David Bergeron of the Department's Policy and Budget Development Unit informed Senator Charles Grassley that "the Department is not prepared to issue further guidance on incentive compensation at this time." The Department subsequently presented draft regulatory amendments concerning incentive compensation to a negotiated rulemaking committee, which stated revenue sharing was not a per se violation of the general prohibition. To date, the Department has taken no further policy actions on this significant issue, despite the issuance of this and other Draft Audit Reports by the OIG.

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

<sup>7</sup> See note 5, supra.

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have been fairly informed of any such agency perspective. Imposition of a multimillion-dollar liability under this dubious, retroactively applied policy interpretation violates traditional notions of due process and basic fairness because the University did not have adequate notice that its conduct would be deemed prohibited.

Moreover, to the best of the University's knowledge, despite the emergence nationally of revenue sharing and similar type contractual understandings between higher education institutions and outside vendors, neither the Department's Office of Postsecondary Education nor Federal Student Aid has previously applied the Incentive Compensation Rule in this manner to any institution, and the OIG has provided no justification or legal authority for enforcing its own internal policy interpretation against the University. We respectfully suggest that the OIG's action is arbitrary and capricious because a regulatory agency must provide an adequate explanation before it treats similarly situated parties differently.

Most significantly, the OIG's apparent claim that sharing of tuition revenue is a per se violation of the Incentive Compensation Rule conflicts directly with recent pronouncements by the Department. On April 17, 2002, the Department presented a negotiated rulemaking committee with draft regulatory changes that – for the first time since the original 1994 promulgation – clarified the official view of scope of the prohibition. That draft provided specific examples of “[a]ctivities and arrangements that an institution may carry out without violating” the prohibition, including with regard to revenue-sharing:

Payments to third parties, including tuition sharing arrangements, that deliver various services to the institution, even if one of the services involves recruiting or admissions activities or the awarding of Title IV, HEA program funds...

This clear pronouncement, while not yet an official ruling of the Department, reveals the internal policy view of those responsible for administering the Title IV programs. Insofar as the Department has determined that sharing of tuition revenues with a third-party service provider does not violate the Incentive Compensation Rule (even where the service provider is engaged in student recruitment activities), the OIG has issued an audit finding against the University based upon regulatory interpretations squarely rejected by the Department.

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

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**B. The OIG's Recommendation -- Disallowance of All Title IV Funds Received by the University for All AGS Enrollees -- Is Unwarranted and Is Inconsistent With Applicable Law and Regulations.**

The Draft Audit Report erroneously asserts at page 3 that "because the University did not comply with the HEA and regulations by paying incentives to IPD based on success in securing student enrollments for its [AGS] programs, the University must return all Title IV funds that were disbursed on behalf of students enrolled" in the AGS programs. On these grounds, the OIG asserts that a staggering amount -- \$19,451,123 -- representing the principal amount of all Title IV loans and grants received by AGS enrollees, should be returned to lenders and to the U.S. Department of Education.

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

In the absence of any OIG statement of reasons, or other detailed explanation, for the extreme sanction, the University cannot presently submit any comprehensive response to the Draft Audit Report's recommendations. We therefore reserve the right and opportunity to respond at a later date, if and when such a statement is presented. In the meantime, we offer the following preliminary statement of reasons why the recommended sanction is unjustified and should be deleted from any final audit report:

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

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- The University and its AGS students utilized the Title IV program funds targeted by the OIG for disallowance for their lawful intended purposes, *i.e.*, to pay the costs of attendance associated with these students' education. The Draft Audit Report presents no finding or allegation to the contrary, nor does it assert any instance where the audit fieldwork revealed that funds were misapplied or unaccounted for. Even though the OIG has pointed to no actual or presumptive harm suffered by ED or by any student, the Draft Report recommends that the University repay all the funds – including principal loan amounts already slated for repayment by the students themselves – that were long since spent to educate these students. The OIG can point to no statute, regulation, or principle of law to substantiate the disallowance sought. The OIG has not even explained why the University should repay funds that were duly applied to their lawful intended purposes, or explained why the University should repay loan principal amounts that the students themselves will repay.
- Nowhere does the Draft Audit Report allege or imply that any individual AGS student lacked federal student financial aid eligibility, based upon alleged noncompliance with the Incentive Compensation Rule or with any other Title IV requirement. The Department's student eligibility rules do not include the Incentive Compensation Rule as a *student eligibility requirement*. Accordingly, no basis exists for the OIG to seek or recommend wholesale disallowance of all federal student financial aid funds received by all AGS students.
- Nowhere does the Draft Audit Report allege or imply that any AGS academic program lacked eligibility for Title IV participation, based upon alleged noncompliance with the Incentive Compensation Rule or with any other Title IV requirement. The Department's program eligibility rules do not include the Incentive Compensation Rule as a *program eligibility requirement*. Accordingly, no basis exists for the OIG to seek or recommend wholesale disallowance of all Title IV funds received by all AGS students.
- The elements of *institutional eligibility* set forth in Title IV and ED's regulations do not include the Incentive Compensation Rule as an institutional eligibility requirement. Although Title IV formerly included a different eligibility provision prohibiting the use of commissioned salespersons to promote the availability of federal loans, Congress repealed that provision when it enacted the Incentive Compensation Rule. In fact, prior to enactment of the Rule, the Congress rejected a proposal that would have made the Rule a component of the definition of an eligible institution of higher education. Accordingly, no basis exists for the OIG to seek or recommend wholesale disallowance of all federal student financial aid funds received by all AGS students.

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- The Draft Audit Report quotes Title IV provisions and ED rules that identify the Incentive Compensation Rule as the twentieth of twenty-six mandatory terms to be included in the institutional Program Participation Agreement (“PPA”) with the Department. However, the PPA terms collectively encompass hundreds of statutory and regulatory requirements prescribed under Title IV of the HEA. No basis exists to support the OIG’s position that an alleged violation of any of these innumerable PPA requirements warrants a wholesale disallowance of all Title IV funds where no statutory or regulatory element of institutional, student, or program eligibility is at issue. The Draft Audit Report does not identify any basis for such an extreme sanction, and various ED administrative decisions support the view that the recommended sanction is both unreasonable and unwarranted. More specifically, the seventeenth PPA term requires institutions to “complete, in a timely manner and to the satisfaction of the Secretary, surveys conducted as part of the Integrated Postsecondary Education Data System.” See 34 C.F.R. § 668.14(b). The OIG’s position would require a total disallowance of all Title IV funds for a violation of that ministerial requirement. If however, the OIG’s position differs regarding that PPA requirement from its position in this case, the OIG is assigning varying degrees of significance to the PPA requirements, thereby modifying a regulatory scheme without notice-and-comment as required by law.
- Given the absence of any factual allegations of actual harm to students or the Department, coupled with the absence of any basis for asserting that the University, its students, or its AGS programs were ineligible for Title IV funds, it would appear that the OIG seeks to impose a wholesale disallowance to punish the University for purported noncompliance. The OIG cannot lawfully seek or recommend punishment in an audit report.
- The Draft Audit Report incorrectly and drastically overstates the amount of purported liabilities arising out of AGS students’ participation in the Title IV programs by erroneously recommending that the University be required to repurchase all Stafford and PLUS loans disbursed to such students. The Draft Report inexplicably ignores established rules limiting the scope and quantity of any audit disallowances of loan funds to the ED’s actual losses. The Department’s established policies and administrative precedent require the application of an actual loss formula that takes into account institutional default rates in lieu of repurchase of all loans. In recommending repurchase of the face amount of these loans, the Draft Audit Report simply ignores the actual loss formula.<sup>8</sup>

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<sup>8</sup> The Draft Audit Report further overstates the value of Title IV funds awarded to AGS students by apparently failing to consider any amounts that may have been refunded, following the initial disbursement, because of changes in students’ enrollment status.

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- The Draft Audit Report's omission of any reference to the Department's long-established actual loss formula, in conjunction with the unfounded and extreme sanctions cited, is highly unfair to the University because the institution has succeeded in achieving consistently low cohort default rates. These rates prove that the arbitrary and capricious disallowance figures set forth by the Draft Audit Report profoundly exaggerate any sanctions that could ever potentially result from the audit. Moreover, the University's cohort default rates prove that, in direct contrast to enrollment abuses targeted by Congress in enacting the Incentive Compensation Rule, the University's recruitment practices suffice to ensure that only qualified, responsible students enroll in its programs.

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

**C. Response To the Draft Audit Report's Assertions With Respect to IPD's Internal Salary Structure.**

The Draft Audit Report further questions whether IPD's internal compensation plans were consistent with the Incentive Compensation Rule. However, Southern Wesleyan University is unable to itself provide a specific response to the OIG's claim because the contract with IPD specified respective areas of responsibility. The University was responsible for maintaining the academic records of AGS students, making all final determinations on AGS admissions, and establishing tuition and fees for programs. See IPD Contract, pages 17-20. The University also exercised exclusive jurisdiction over curricula content and approval, and retained authority over instructional personnel for the AGS programs. Id. at page 5, 18. However, IPD was responsible for the costs for all services to be rendered under the terms the contract, including but not limited to payroll.

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

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### **IPD Recruiter Salaries Do Not Violate The Incentive Compensation Rule**

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

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

1. The Incentive Compensation Rule does not prohibit salary based on success in securing enrollments.

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

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

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

2. The legislative history of the Incentive Compensation Rule makes clear that Congress intended to permit recruiter salaries to be based on merit.

Even if one erroneously presumed that the Incentive Compensation Rule could extend to certain recruiter “salaries,” Congress made clear in enacting the 1992 amendments to the HEA

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that salary based on success in securing enrollments is not prohibited so long as it is not based solely on success in securing enrollments. Specifically, the Conference Committee that resolved the House and Senate differences in the 1992 HEA Amendments stated that the statute does not prohibit salary that is based on merit, even if measured, in part, by success in securing enrollments. The Committee's report states in pertinent part:

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

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

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

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

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

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

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

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

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

## **II. SOUTHERN WESLEYAN UNIVERSITY'S ADULT AND GRADUATE STUDIES PROGRAMS COMPLY WITH THE 12-HOUR RULE.**

The University conclusively demonstrates that its AGS programs satisfied the 12-Hour Rule and that such compliance is fully and appropriately documented. The additional documentation sought by the OIG exceeds any level of documentation required by the applicable statutes and regulations. Additionally, the recommended liability is based on an erroneous methodology and excludes significant amounts of time that count toward compliance with the 12-Hour Rule and demonstrates a lack of familiarity with the AGS programs.

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**A. The University Has Adequately Documented Its Compliance with the 12-Hour Rule.**

The AGS programs deliver high-quality, accredited educational content to adult “lifelong learners” and other nontraditional students through two integrated instructional components. All students meet once a week in large groups with a faculty member for four hours, and again each week in smaller “study groups.” The study groups generally consist of no more than five students, which meet at an agreed-upon location for four hours of additional instructional activities. Because all AGS courses include at least eight hours of instruction per week, and the duration of the programs is 45 weeks, the University provides at least 360 instructional hours to all AGS students. The Draft Audit Report acknowledges on page 6 that the University produced evidence specifically supporting the occurrence of 46 percent of the required study group hours. That evidence demonstrates the University’s diligence in applying multiple layers of monitoring controls to study groups, which it did in the absence of any federal guidance for 12-Hour Rule compliance. However, the OIG inexplicably disallows the documented study group hours, as well as the study group hours for which the OIG claims a lack of documentation. Draft Audit Report at 6. As a result, the OIG claims that the AGS programs provide only one-half of the instructional time required by the 12-Hour Rule. This arbitrary rejection of previously accepted documentation raises serious questions as to the legitimacy of the OIG’s claim that the disallowance of study group hours is actually based on the lack of sufficient monitoring controls.

The Department has already concluded that “[t]here is no meaningful way to measure 12 hours of instruction”<sup>9</sup> for nontraditional education programs like those questioned by the Draft Audit Report. As a result of this conclusion, the Department has recently advocated repeal of this “unworkable” rule<sup>10</sup> altogether, proposing its elimination to a negotiated rulemaking committee earlier this year. The OIG is now attempting to hold the University accountable to specific, unstated attendance tracking procedures and other documentation rules created through its audit process, which have already been repudiated by the Department. This action is without any legal justification, and stands in stark contrast to the limited and vague regulatory guidance provided by the Department to date. Despite the vast confusion created by the Department about this issue, and contrary to the erroneous assertions contained in the Draft Audit Report, the University implemented elaborate attendance tracking policies and followed specific procedures to ensure that the AGS programs provided the requisite amount of “regularly scheduled instruction, examinations, or preparation for examinations” required by the 12-Hour Rule,

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<sup>9</sup>U.S. Department of Education, Office of Postsecondary Education, “Report to Congress on the Distance Education Demonstration Programs” (January 2001), at page 24.

<sup>10</sup>The Secretary of Education stated in a July 31, 2001 letter to Congress that the 12-Hour Rule “has been shown to be unworkable for many nontraditional formats.” 145 Cong. Rec. H6465, H6466 (daily ed. Oct. 10, 2001).

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published at 34 C.F.R. § 668.2(b)(2)(ii)(B).

1. Study group meetings constitute instructional activity.

The AGS study group meetings fall within the scope of “regularly scheduled instruction, examinations, or preparation for examinations.” The regulatory text confirms this conclusion, stating that “instructional time” excludes “activity not related to class preparation or examinations,” 34 C.F.R. § 668.2(b)(2)(iii), implying that activity related to class preparation or examination is included. The study group meetings entail completing academically rigorous projects, learning course content, and engaging in group tasks that develop and enhance problem-solving skills that are integral to the students’ achievement of designated course outcomes. The study group meetings are, therefore, clearly related to class preparation, and qualify as instructional activity under the 12-Hour Rule.<sup>11</sup>

2. The University implemented pre-enrollment procedures to ensure students’ awareness of the study group attendance requirements.

From the first moment that potential students expressed interest in the AGS programs, the University repeatedly advised them of the mandatory nature of study group attendance. All recruitment and marking literature discussed the study group requirement, and an information seminar for all prospective applicants similarly discussed the weekly four-hour time commitment to study group meetings. Following a student’s application to the AGS programs, the University required a pre-enrollment advising session, during which SWU reiterated the necessity of attending four hours of study group meetings per week. This pre-enrollment advising also included the development of a Degree Completion Plan for each student, as well as the completion of a mandatory academic counseling checklist that included the study group requirement. In order to enroll in the AGS program, a student was required to check each item on the academic counseling checklist, and sign a statement that he or she understood all requirements, including study group attendance.

One week following the pre-enrollment advising, all AGS students participated in a mandatory one-hour academic orientation. This orientation discussed all academic requirements of the AGS programs, general University policies and procedures, and other campus rules and regulations. At the same time, an advisor walked students through each and every element of the

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<sup>11</sup> The Draft Audit Report does not seem to dispute that study group meetings constitute instructional activity, and acknowledges that SWU provided probative evidence (under an unstated standard) supporting 46 percent of study group hours. However, the OIG then excludes all of the AGS study group meetings from its 12-Hour Rule calculations because the University allegedly fails to satisfy some broader and unsupported documentation rule. The OIG reaches its conclusion despite extensive evidence to the contrary, much of which was specifically provided to the OIG auditors.

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student handbook, including the handbook's requirement of four hours of weekly study group attendance. Each student received a personal copy of the student handbook during this orientation session.

The Draft Audit Report mentions none of the above procedures or documents, and the OIG has provided no indication that it properly examined these pre-enrollment advising materials. This discrepancy (among others discussed below) calls into question the thoroughness of the audit process, particularly where the OIG has made a blanket assertion that the University "did not have management controls in place" to ensure compliance with the 12-Hour Rule. As is shown below, the pre-enrollment advising procedures are just one method by which the University implemented management controls over the study groups. The OIG either ignored this readily available evidence, or arbitrarily rejected it in order to support a predetermined audit finding that fits a predetermined agenda.

3. Study group meetings were regularly scheduled and closely monitored by the University.

The curriculum module for each AGS course expressly establishes the weekly study group requirement, and requires students to attend study group meetings in order to discuss course material, prepare graded assignments, and share learning resources. Each student is expected to contribute to the completion of all study group assignments, which include oral and written presentations. In the first course for all AGS programs, faculty members reiterated the study group meeting requirements. The students, in the first week of the program, completed a "Study Group Constitution" listing the names and addresses of all group members, and typically stating the day, time, and location of their weekly study group meeting. The faculty member for the course collected each Study Group Constitution, reviewed its contents, and approved or disapproved the study group meeting location. In all cases, any proposed location for study group meetings must have been conducive to learning.

Several other factors clearly indicate that the study group meetings were "regular," "scheduled," and under appropriate supervision by University faculty. The specific tasks to be performed and completed by the study group in a given week were specified in the course module, and all students enrolled in the course were required to participate in study group activities. Each designated study group session was, by curriculum design, slated to occur between specified meetings with the faculty instructor. During study group meetings, students completed rigorous team assignments, often preparing specified projects that were presented during the next faculty-led workshop, in order to progress academically in the course. Finally, the faculty exerted control over the study group meetings by reviewing and grading the designated team assignments and projects. The study group meetings were therefore "regularly scheduled" as required by the 12-Hour Rule, and the Draft Audit Report's conclusions to the contrary are simply wrong.

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Southern Wesleyan University implemented an additional significant control over study groups by requiring weekly completion of "Study Group Logs." These logs include space for each study group member to sign and indicate his or her attendance; the date, starting time, and ending time of the meeting; and the course assignment covered during the meeting. Faculty members reviewed these logs on a weekly basis, and initialed the logs each week to indicate such review and approval. Although provided to the OIG and reviewed by the auditors, the Draft Audit Report makes no mention of these study group logs. In doing so, the OIG once again appears to purposefully ignore specific, probative evidence that would undermine predetermined conclusions.

University monitoring of study group attendance is also reflected by mandatory End-of-Course evaluations completed by all AGS students. These evaluations contain questions regarding the study group meetings, and specifically regarding the attendance of other study group members. The OIG either failed to review these evaluations, summarily and wrongly rejected them as insufficient documentation, or simply ignored them to reach a desired audit finding. The Draft Audit Report further ignores the fact that University faculty and staff spent time resolving conflicts within study group memberships or providing academic direction and guidance. If a student did not attend the weekly meetings, the University's student services office would administratively transfer that student to another study group or withdraw the student from the AGS program altogether.

The documents provided to the OIG auditors demonstrate that SWU conscientiously implemented a variety of significant controls over study groups. However, the OIG dismisses the course module statements describing study group projects, fails to consider the Study Group Constitutions, ignores the Study Group Logs, rejects the End-of-Course evaluations, and disregards the involvement of SWU faculty and administrators with study group members. Presumably, the OIG discards all of this documentation in order to reach a pre-determined conclusion that the University did not "ensure that study group meetings were regularly scheduled and occurred." Draft Audit Report at 5. This statement simply and wrongly ignores readily available and voluminous evidence to the contrary.

In addition to demanding an unjustified amount of documentation, the OIG is fundamentally mistaken in its claim that the University must "ensure" that students actually attended each study group occurrence. Even assuming that "ensure" has a defined meaning, there is no manner for the University to "ensure" such attendance short of physically compelling students to be present at all times. If the OIG equates "ensure" with monitoring and oversight (which the University has adequately fulfilled through a variety of detailed methods), then the OIG is using the term "ensure" in a much broader and inappropriate context. There is simply no statutory or regulatory basis for the OIG's claim, and the report provides no legal authority for its broader interpretation of the rule. Rather, all that is required by the 12-Hour Rule is that study

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group meetings were “regularly scheduled,” which they were as described above. This more reasonable interpretation, tracking the actual text of the regulation, is consistent with amendments to the 12-Hour Rule that took effect July 1, 2001. The revised 12-Hour Rule requires an institution to provide “[a]t least 12 hours of regularly scheduled instruction or examination” or “[a]fter the last scheduled day of classes for a payment period, at least 12 hours of study for final examinations.” 34 C.F.R. § 668.2(b)(2) (2001). The regulation does not require the minimum 12 hours of study, after the last day of classes, to occur under direct faculty supervision or for the University to somehow document that each and every student actually studied at least 12 hours during the period between classes and exams. This revision makes clear that the focus of the rule, both before and after the regulatory change, is on whether instructional time is “regularly scheduled” and not on whether an institution can document that students actually completed twelve hours of instructional activity in any given week. Southern Wesleyan University not only fulfilled the requirements of the 12-Hour Rule, but exceeded them with significant weekly monitoring of study group attendance.

4. Study groups are part of an integrated curriculum module, and faculty members were aware of which students did not attend the study group meetings in any given week.

The Draft Audit Report also reflects the OIG’s purported documentation rule in apparently requiring the physical presence of a faculty member or other University official for instructional time to count towards 12-Hour Rule compliance.<sup>12</sup> However, the 12-Hour Rule expressly states that time spent in “preparation for examinations” is included in the overall calculation of instructional activity. Clearly the regulation does not require a faculty member or University official to be present whenever a student studies or prepares for examination, in order for such time to be included.

Likewise, faculty presence during study group meetings is not required for the faculty member to assess whether a student adequately participated in the weekly study group meetings. The course module indicates that study group meetings are devoted to the development of group projects and preparation of presentations for the next faculty-led course workshop. These projects and presentations are graded and comprise part of each student’s final grade.<sup>13</sup> In

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<sup>12</sup> “[AGS] students were required to meet in class for four hours per week, and were expected to meet an additional four hours per week in study groups.... It [was] the policy of SWU AGS administrative staff not to interfere with the make-up or operation of any study group.” Draft Audit Report at 5 (internal quotations omitted). The OIG’s statements oversimplify the oversight that faculty members must exert over study groups in order to assess student performance, and ignores express statements in the student handbook and course catalog that study group attendance was mandatory.

<sup>13</sup> The Department is statutorily barred from exercising any “direction, supervision, or control over the curriculum” of the University. 20 U.S.C. § 1232a. Therefore, to the extent this audit raises questions about the AGS course

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addition, the faculty members reviewed all study group logs on a weekly basis, as discussed above.

5. Additional hours spent by students in preparation for examinations are includable under the 12-Hour Rule.

Some AGS courses utilize traditional examinations, in addition to the study group presentations and other weekly graded activities. The Draft Audit Report ignores the additional hours spent by students in those courses preparing for their examinations, although the 12-Hour Rule explicitly permits time spent in "preparation for examinations" to be counted towards compliance. The OIG's purported documentation rule essentially requires all exam preparation to be strictly regulated by the University or supervised by a faculty member, in order for the time to be included. Because that level of supervision is not required by any legal authority, any calculation under the 12-Hour Rule must presume, by the simple fact the exams occurred, that students in those courses were expected to spend, and did spend, additional time preparing for the exams.

6. Although the University implemented significant measures to monitor study group attendance, there is no statutory or regulatory basis for the OIG's requirement that the University "ensure that study group meetings were taking place."

The 12-Hour Rule requires only a minimum number of "regularly scheduled" instructional hours. As previously discussed, the Draft Audit Report is a far-reaching attempt to expand the rule to require such hours be actually physically attended by every relevant student, and that the University specifically document each student's "seat-time" in the study groups. This action by the OIG ignores the Department's prior statements about the nature and scope of the rule. When promulgating the regulation and considering a variety of educational contexts, the Department published the following:

*Comments:* One commenter observed that many external degree and adult learning programs are trying to reduce the number of days spent in the classroom. One commenter requested that the Secretary utilize the diversity and plurality of the education system by recognizing the amount of time the student spends in different educational settings. . . .

*Discussion:* The Secretary agrees that internships, cooperative education programs, independent study, and other forms of regularly scheduled instruction can be considered as part of an institution's academic year.

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curriculum, such issues are plainly beyond the OIG's scope of authority.

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59 Fed.Reg. 61148 (Nov. 29, 1994) (emphasis added). Significantly, the Department did not use a phrase such as “actually provided instruction” or “instruction with documented attendance” to explain the scope of the rule. The concern of the Department was simply that educational programs, particularly non-traditional, “lifelong learning” programs like the AGS programs at issue in the present audit, have a minimum amount of “regularly scheduled instruction.” In addition, the Department based the 12-Hour Rule on its definition of a full-time student (see Section II below). The regulations define a “full-time student,” in relevant part, as follows:

*Full-time student:* An enrolled student who is carrying a full-time academic workload (other than by correspondence) as determined by the institution under a standard applicable to all students enrolled in a particular educational program. The student’s workload may include any combination of courses, work, research, or special studies that the institution considers sufficient to classify the student as a full-time student....

34 C.F.R. § 668.2 (emphasis added); see also 34 C.F.R. § 682.200. The emphasized language demonstrates the Department’s recognition that a student’s academic workload may consist of activities including “work,” “research,” and “special studies that the institution considers sufficient.” There is no stated requirement, however, for an institution to specifically document each and every hour spent by a student on such activities, so long as they are “regularly scheduled.” Notwithstanding the lack of a legal requirement, the University did implement significant measures to monitor students’ attendance at study group meetings, including the aforementioned study group logs.

The Draft Audit Report simply provides no basis in statute, regulation, published guidance, or case law to support its heightened requirement that the University monitor all students’ actual attendance for the “regularly scheduled instruction” to be counted under the 12-Hour Rule. Moreover, any attempt by the OIG to establish such a policy through this audit constitutes improper agency rulemaking and falls outside the scope of the OIG’s authority under the Inspector General Act of 1978, which precludes an agency from delegating “program operating responsibilities” to an OIG. See 5 U.S.C. App. 3 § 8G(b).

**B. The 12-Hour Rule Is Widely Acknowledged to be Unworkable and Ill-Suited For Nontraditional Educational Programs.**

The underlying basis for the 12-Hour Rule and its continued applicability to the Title IV programs are presently in serious doubt, particularly as applied to nontraditional educational programs such as those offered in the University’s AGS programs. The section of the Higher Education Act concerning the minimum period of academic instruction for Title IV eligibility

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reads:

[T]he term “academic year” shall require a minimum of 30 weeks of instructional time, and with respect to an undergraduate course of study, shall require that during such minimum period of instructional time a full-time student is expected to complete at least 24 semester or trimester hours or 36 quarter hours at an institution that measures program length in credit hours.

20 U.S.C. § 1088(a)(2). The HEA mandates nothing further regarding the length or structure of a traditional, four-year institution of higher education’s period of undergraduate instruction. In regulations implementing the above HEA provision, however, the Department created an additional requirement for educational programs that use credit hours but that do not use a semester, trimester, or quarter system. For such programs, “the Secretary considers a week of instructional time to be any week in which at least 12 hours of regularly scheduled instruction, examinations, or preparation for examinations occurs.” 34 C.F.R. § 668.2(b)(2)(ii)(B).<sup>14</sup> This requirement was added by regulation without any statutory basis, and as the Inspector General testified to Congress, “[t]here is no [statutory] specificity in what can be included as instruction for determining an institution’s academic year and credit hours for the awarding of [Title IV] funds.”<sup>15</sup>

The appropriateness of the 12-Hour Rule, and the immeasurable burden it creates for institutions that wish to prove compliance, have recently come under increased scrutiny. In 2001, the conference report to the Department’s annual appropriations bill included the following observation:

The conferees are aware of concerns in the higher education community about the so-called “12 hour rule” and its unsuitability to address the needs of institutions of higher education throughout the nation that serve non-traditional students engaged in lifelong learning. The conferees are concerned about the potential for enormous paperwork burdens being placed on institutions of higher education in their attempts to comply with the 12-hour rule.

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<sup>14</sup> For educational programs that use a semester, trimester, or quarter system, “the Secretary considers a week of instructional time to be any week in which at least one day of regularly scheduled instruction, examinations, or preparation for examinations occurs.” 34 C.F.R. § 668.2(b)(2)(ii)(A).

<sup>15</sup> Testimony of Lorraine Lewis, U.S. Department of Education Inspector General, before the U.S. House of Representatives Committee on Education and the Workforce, Subcommittee on 21st Century Competitiveness, concerning H.R. 1992, the “Internet Equity and Education Act of 2001” (June 21, 2001).

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More recently, and during the course of this audit, Congress has considered legislation to repeal the 12-Hour Rule. The “Internet Equity and Education Act of 2001” (H.R. 1992), which passed the House of Representatives on October 10, 2001, would uniformly define “week of instructional time” to be “a week in which at least one day of instruction, examination, or preparation for examination occurs,” thus legislatively negating the regulation creating the 12-Hour Rule. The bill is a tacit acknowledgement of the Department’s own findings that “[t]here is no meaningful way to measure 12 hours of instruction” for courses “typically structured in modules that combine both what [traditionally] might be considered instruction and out-of-class work, so there is no distinction between instructional time and ‘home work.’”<sup>16</sup> The University’s AGS course modules – combining traditional, faculty-led “classes,” mandatory “study groups” in which students worked on graded group projects, and individually assigned graded projects – fall within this category of educational programs. The AGS programs thereby exemplify the regulatory dilemma created by the 12-Hour Rule.

Of particular significance is the Department’s proposal, during negotiated rulemaking activities earlier this year, to eliminate the 12-Hour Rule entirely. Although those rulemaking sessions did not reach a consensus, the Department publicly indicated its direct intent to repeal the regulation, and a proposed rule is anticipated in the very near future.<sup>17</sup> We are at a loss to understand the OIG’s purpose in applying a rule that the Department itself calls “unworkable,” believes is totally unnecessary and is about to eliminate. The OIG’s imposition of sanctions for alleged violations of the rule is similarly without merit. The University therefore objects to the issuance of the Draft Audit Report concerning the 12-Hour Rule, and having to respond to the OIG at this time, when the Department is obviously uncertain about its continued applicability.

**C. The Recommended Liability Is Based On An Erroneous Methodology and Excludes Significant Amounts of Time That Count Toward Compliance with the 12-Hour Rule.**

The OIG further fails to consider that instructional activity includable under the 12-Hour Rule necessarily occurs outside of both the faculty-led classes and the study group meetings. For example, the regulation permits time spent in “preparation for examinations” to be counted. The OIG’s purported documentation rule either ignores this portion of the regulation, or has wrongly adopted an interpretation requiring all preparation to be strictly regulated by the University,

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<sup>16</sup> U.S. Department of Education, Office of Postsecondary Education, “Report to Congress on the Distance Education Demonstration Programs” (January 2001), at page 24. While the quoted statement was made in specific regard to “distance education” courses, the Report goes on to define such nontraditional courses in a manner that is equivalent to the educational programs at issue in this audit.

<sup>17</sup> See Chronicle of Higher Education (Daily News), “After Panel Deadlocks, Education Department Vows to Relax 12-Hour Rule Itself,” (April 29, 2002), available online at <http://chronicle.com/free/2002/04/2002042901u.htm>.

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supervised by a faculty member, or take place in closely-monitored University facilities. Students' grades for AGS courses are determined through traditional examinations, graded individual presentations and papers, graded group projects, or a combination thereof. Although it cannot be, nor is it required by any legal authority to be, monitored and measured by the University, any calculation under the 12-Hour Rule must presume that students spent additional time preparing for these examinations and graded activities. That additional time must be included in any calculation of course length, and the liability recommended by the Draft Audit Report is therefore based on a faulty methodology.

**CONCLUSION**

For all of the foregoing reasons, Southern Wesleyan University strenuously disagrees with the preliminary findings and recommendations set forth in the Draft Audit Report, and we urge the Office of Inspector General to close the audit without a determination of liability. We reserve the right and opportunity to respond further to any final report as may be issued.

Respectfully submitted,

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Dr. David J. Spittal, President

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