Baker University
School of Professional and Graduate Study's
Administration of Title IV
Federal Student Aid Programs

FINAL AUDIT REPORT
ED-OIG/A07-A0030
September 2002

Our mission is to promote the efficiency, effectiveness, and integrity of the Department's programs and operations.

U.S. Department of Education
Office of Inspector General
Kansas City, Missouri Office

NOTICE

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

SEP 1 9 2002

Dr. Daniel M. Lambert, President
Baker University
618 8th Street
P.O. Box 65
Baldwin City, KS 66006-0065

Dear Dr. Lambert:

Attached is our report entitled Baker University's School of Professional and Graduate Study's Administration of the Title IV Student Financial Assistance Programs (Control No. ED-OIG/A07-A0030). The report incorporates the comments you provided in response to the draft audit report. 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 Education Department official, who will consider them before taking final Departmental action on the audit:

Teresa Shaw, Chief Operation Officer
Federal Student Aid
Union Center Plaza Building, Room 112G1
830 1st Street, NE
Washington, D.C. 20202-5402

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 to the Department's grantee and contractors are made 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.

Sincerely,

[redacted]

Thomas A. Carter
Assistant Inspector General
for Audit Services

Attachment

Baker University
School of Professional and Graduate Study's
Administration of the Title IV
Student Financial Assistance Programs

Executive Summary

Baker University (the University) is a private not-for-profit, coeducational, liberal arts institution affiliated with the United Methodist Church. Our objectives were to determine whether the University complied with the Higher Education Act (HEA) and applicable regulations pertaining to (1) the prohibition against the use of incentive payments for recruiting activities, and (2) course length. We found that:

- The University violated the statutory prohibition on the use of incentive payments based on success in securing student enrollments. The University contracted with the Institute for Professional Development (IPD) to provide recruiting and accounting services for its School of Professional and Graduate Studies (SPGS). In accordance with the terms of the contract, IPD received payments based on the number of students enrolled in the SPGS programs. In addition, IPD paid its recruiters based on the number of students they recruited who enrolled in the programs. Because the University did not comply with the HEA and regulations by paying incentives to IPD based on success in securing enrollments, the University must return $13,612,816 in Federal Stafford loan funds, $257,791 in Pell Grant funds, and $64,688 in Supplemental Educational Opportunity Grants disbursed on behalf of students who were improperly recruited for its SPGS programs.

- The University's academic year for its SPGS programs did not provide the number of instructional hours required by the HEA and the regulations. The HEA states that an academic year must contain a minimum of 30 weeks of instruction. The regulations for programs not using semester, trimester, or quarter systems require a minimum of 12 hours of instruction per week. These regulations are commonly known as the 12-Hour Rule. The University did not ensure that its SPGS programs provided the required amount of instructional time. Because the University's academic year did not provide the required number of instructional hours, the University disbursed funds to students who were not eligible for all or part of the funds. We estimated that the University improperly disbursed $1,672,276 in Stafford loans, and $108,704 in Pell Grant funds to students in the SPGS programs.[1]

[1] The dollars we estimated as improperly disbursed are duplicative of the dollars we determined as improperly disbursed in the incentive-based payments finding.

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

- Amend and/or terminate its contractual relationship with IPD to eliminate payments based on success in securing student enrollment.
- Establish an academic year for its SPGS programs that satisfies the requirements of the 12-Hour Rule.
- Return to lenders and the Department $13,935,295 in Title IV funds disbursed to students who were improperly recruited.
- Return to lenders and the Department $1,780,980 in Title IV funds that were in excess of the amounts the students were entitled as a result of not being in compliance with the 12-Hour Rule.[2]

The University provided narrative comments in response to our draft report. The University's narrative comments are included in their entirety in Attachment 1. The University did not concur with our findings or recommendations. We summarized the University's comments and provided our response following each finding. Our analysis of the University's comments did not persuade us to change our overall conclusions or recommendations for any of the findings.

[2] The amounts identified to be returned are duplicative of the amounts to be returned for students who were improperly recruited. Only those amounts not returned as a result of our first finding should be returned to lenders and the Department.

Audit Results

We determined that the University needed to improve its administration of the Title IV programs. We found that the University violated the statutory prohibition on the use of incentive payments for recruiting based on success in securing enrollment when it paid the Institute for Professional Development a percentage of tuition for students enrolled in its SPGS programs. In addition, the University's academic year for its SPGS programs did not provide the required number of instructional hours as defined in the HEA and the regulations.

Finding No. 1 – The University Contracted With An Organization That Received Payments Based on the Number of Students Enrolled in SPGS Programs

Baker University entered into a contract with IPD that provided for incentive payments to IPD based on success in securing enrollment for the SPGS programs. In addition, IPD's recruiters received payments based on their success in enrolling students. The Higher Education Act (HEA) expressly prohibits any type of incentive payment based directly or indirectly on success in securing enrollments. As a result of incentive payments to IPD, the University is liable for all Title IV funds awarded to students in the SPGS programs who were improperly recruited from July 1, 1996, through the present.

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

The 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 CFR § 668.14(b)(22) codify the statutory prohibition on incentive payments based on securing enrollment.

> By entering into a 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 Received Payments Based on Student Enrollment in SPGS 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 SPGS programs. The contract stated that IPD shall:

- Recruit students to enroll in the courses of study in the SPGS programs.
- Provide representatives to recruit students for the programs covered under this agreement.
- Provide an average initial enrollment of 16 students per class during each year of the contract.
- Be responsible for the preparation of promotional literature.
- Collect, on behalf of Baker University, all tuition and application fees, book and material fees, college-level assessment fees, and other fees payable by a student and applicable to the programs.
- Maintain the official program accounting books and records.

Book, material, and computer fees were remitted in full to the University. Tuition fees were divided between the parties on a weekly basis in accordance with the contract as outlined in the table below. Refunds were paid from the joint account according to these percentages.

Location	Dates Effective During Audit Period	Programs	Baker Percentage	IPD Percentage
Overland Park & Topeka Campus	7/1/96 – 6/30/99	BBA, BSM, MSM, MBA, Bridge	60	40
Overland Park & Topeka Campus (new program effective 8/25/97)	8/25/97 – 6/30/99	AAB	55	45
Wichita Campus (location approved 8/8/97)	8/8/97 – 6/30/99	BBA, BSM, MSM, MBA, AAB	50	50

The University Violated the HEA by Paying IPD Based on Success in Securing Enrollments for the SPGS Programs Which Resulted in $13,935,295 of Improperly Disbursed Title IV Funds

Because the University did not comply with the HEA and regulations by paying incentives to IPD based on success in securing enrollments for its SPGS programs, the University must return all Title IV funds that were disbursed on behalf of students enrolled in the SPGS programs who were improperly recruited. Since the University paid incentives for each student enrolled in the six SPGS programs included in our review, all students in the SPGS programs were improperly recruited. The University must return all Title IV funding that it disbursed for the SPGS programs from July 1, 1996, through the present. We determined that the amount of Stafford loan funds from July 1, 1996, through June 30, 1999, was $13,612,816. In addition, we determined that the amount of Pell Grant and SEOG funds disbursed for the same period was $257,791 and $64,688, respectively.

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

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

Recommendations

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

1. Immediately amend and/or terminate its present contractual relationship with IPD to eliminate incentive payments based on student enrollment.

2. Return to lenders the Stafford loan funds of $13,612,816 disbursed from July 1, 1996, through June 30, 1999. Also, the University should repay the Department the interest and special allowance costs incurred on Federally subsidized loans.

3. Return to the Department Pell Grant and SEOG funds of $257,791 and $64,688, respectively, disbursed from July 1, 1996, through June 30, 1999.

4. Determine the amounts of Stafford loan, Pell Grant and SEOG funds improperly disbursed since the end of our audit period and return the funds to lenders and the Department.

University Comments and OIG Response

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

<u>The Allocation of Revenue Under the IPD Contract Does Not Violate the Incentive Compensation Rule</u>

The University stated that:

- The IPD contract compensates IPD based on the volume of a broad range of professional services provided to Baker University, many of which have variable costs dependant on the number of students enrolled in the SPGS 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 regulations or other public guidance supporting the interpretation of revenue-sharing agreements advanced by the OIG and in the Draft Audit Report. Indeed, the only public pronouncement from the Department is contrary to the position of the OIG.

<u>The IPD Contract Compensates IPD Based on the Volume of a Broad Range of Professional Services Provided to Baker University</u>

The University stated that 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 SPGS programs:

- Management consulting and training regarding
    - program administration and evaluation,
    - assessment center organization and management,
    - student tracking systems development and implementation,
    - student tuition and financial aid accounting,

    - marketing research and development,
    - faculty recruitment and assessment, and
    - ongoing curriculum review and revision.
- Academic quality audits and mock accreditation reviews for SPGS programs.
- Administrative support for all SPGS staff.
    - Office space for SPGS administration.
    - Telephones, copier, and computers for SPGS administrative offices.
    - Administrative personnel (receptionist, secretaries, etc) for SPGS administrative offices.
- Acquisition and maintenance of appropriate classroom facilities for SPGS programs.
- Professional development and training activities for University's financial aid staff, student services personnel, and SPGS faculty.
- Feasibility studies concerning potential expansion of SPGS programs.
- Maintenance of accounting records, and financial planning and budgeting, in conjunction with the University's Office of Financial Services.

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. The OIG wrongly implies that recruitment and tuition collections constituted IPD's only functions with respect to the SPGS programs.

<u>OIG Response</u>

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

While we recognize that IPD logically had to incur expenses to provide the program accounting services, and any additional services that may have been provided by IPD, these expenses are not relevant 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 students whose enrollments were secured by the University. The agreement also included a minimum enrollment guarantee that, if not achieved, would result in a reduction in revenue to be allocated to IPD, despite other services that might have been provided. This further emphasizes that the revenue stream is completely generated by, and dependent on, student enrollment.

Baker University does not dispute that the payments it made to IPD were based on a percentage of the tuition and fees paid by students enrolled in the SPGS programs. Baker University likewise does not dispute that IPD was responsible for recruiting students. Nor does Baker University dispute that some portion of the amount it paid to IPD was directly related to IPD's success in recruiting students for enrollment in the SPGS 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 Baker University based on the number of students enrolled in the program, Baker 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 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 not relevant since the allocation violates the law.

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

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

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

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

<u>The Incentive Compensation Rule Does Not Apply to the IPD Contract</u>

The University stated that 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. 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.

OIG Response

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

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 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. 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.

OIG Response

The HEA prohibition (§ 487(a)(20)) of 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 (PPA) 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 success in securing student enrollment.

The OIG's Recommendation – Disallowance of All Title IV Funds Received by the University for All SPGS Enrollees – Is Unwarranted and Is Inconsistent With Applicable Law and Regulations

The University stated that the OIG offers neither legal authority nor analysis to justify or explain why disallowance of all SPGS-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 recommendation.

OIG Response

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

IPD Recruiters' Salaries Do Not Violate the Incentive Compensation Rule

IPD stated that its compensation plans based recruiter salaries on factors or qualities that are not solely related to success in securing enrollments. It also stated that the prohibition in § 487(a)(20) did not extend to salaries. Even if salaries were included, IPD stated that salaries could be based on merit or success in securing enrollment as long as enrollment was not the sole factor.

OIG's Response

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

Finding No. 2 – The University's Academic Year for Its SPGS Programs Did Not Provide the Required Number of Instructional Hours

We found that the University did not establish and implement adequate management controls to support the number of instructional hours to meet the statutory definition of an academic year for its SPGS programs. The University disbursed Title IV funds to students who were not eligible for all or part of the funds. We estimated that the University improperly disbursed $1,672,276 in Stafford loan funds, and $108,704 in Pell Grant funds to its SPGS students.[3]

Nonterm Institutions Must Provide a Minimum of 360 Hours of Instructional Time in an Academic Year

Section 481(a)(2) of the HEA states that the term academic year shall:

> [R]equire 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 CFR § 668.2(b) clarify what constitutes a week of instructional time.

> [T]he 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 of the Federal Register dated 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 12 hours per week, the classes would need to be held for 30 weeks to result in 360 hours.

[3] The dollars we estimated as improperly disbursed are duplicative of the dollars we determined as improperly disbursed in the incentive-based payments finding.

The University measured its SPGS educational programs in credit hours, but did not use a semester, trimester, or quarter system. The SPGS 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 24 credit hours in 45 weeks. To comply with the 12-Hour Rule, the University would need to provide 8 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 Adequate Management Controls to Ensure That Students Received the Required 360 Hours of Instruction For Each Academic Year

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 SPGS Student and Faculty handbooks, students were required to meet for four hours per week in regular workshops and an additional four hours per week in study groups. The University counted the study group time for purposes of the 12-Hour Rule. We determined that the University did not establish and implement adequate management controls to ensure that study group meetings were regularly scheduled and occurred.

It was the University's policy that an instructor be present at regular classes and maintain attendance records for the classes. The faculty handbook required the instructor to take attendance at each class, and forward attendance records to the SPGS office at the end of the course. Students were required to notify faculty members if they were going to be absent from class, make arrangements to complete missed assignments, and complete any required make-up assignments. The University did not apply these policies to study groups. Faculty were not required to monitor study group attendance. The faculty handbook outlined the following University policy for attendance: "Under no circumstances may a student miss more than 40 percent of course meeting hours and receive credit for the course." It further stated that this policy is not at the discretion of the faculty member. The Director of Academic Records stated that the policy for study group attendance was at the discretion of the faculty member. The Director of Academic Records also stated that it was not mandatory for students to turn in any type of study group records and if some type of documentation were provided to student services it was thrown away after the cohort was completed.[4]

We statistically selected a sample of 60 student/class combinations from a universe of 14,258 unique student/class combinations. A student/class combination is defined as an SPGS student and all the study group hours required for each class taken by that student during our audit period. We found that the University could not provide evidence that the required number of study group hours were scheduled and occurred for any of the required hours in our sample. From our sample results, we estimate that the University had no support that study group hours were scheduled and occurred. Based on our review of the University's written policies and procedures, review of study group records, and interviews with University officials, we

[4] Baker University began collecting study group attendance sheets from students on October 1, 2000.

determined that the University did not provide adequate 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 Improperly Disbursing $1,780,980 of Title IV Funds to Its SPGS Students

Because the University did not ensure that study group meetings were actually scheduled and taking place, the meetings do not qualify for inclusion in the 12-Hour Rule calculation. As a result, the University-defined academic year of 45 weeks only provided 180 hours of the required minimum of 360 hours of instructional time (four hours of instruction per week for 45 weeks equals 180 classroom 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 the Stafford loan and Pell Grant programs. We estimated that the University improperly disbursed $1,780,980 of Title IV funds to SPGS students. The students included in this amount had disbursements for Stafford loans and Pell Grants during our audit period July 1, 1996, through June 30, 1999.

- **Stafford Loan Limits.** 34 CFR § 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 CFR § 682.204. We estimated that $1,672,276 in Stafford loan disbursements exceeded the annual loan limits.

- **Pell Grant Maximum.** 34 CFR § 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 $108,704 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 SPGS programs did not meet the requirements of the 12-Hour Rule, the University has improperly disbursed Title IV funds for its students on Stafford loan and Pell Grants awarded during our audit period July 1, 1996, through June 30, 1999.

Recommendations

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

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

2. Return to lenders the Stafford loan funds disbursed that exceeded the loan limits for an academic year. We estimated that the amount was $1,672,276 for students who had disbursements for loans during the audit period of July 1, 1996, through June 30, 1999. Also, the University should repay the interest and special allowance costs incurred on Federally subsidized loans.

3. Return the Pell Grant funds disbursed to students that exceeded the allowable award for an academic year. We estimated that the amount was $108,704 for students who had Pell Grants during our audit period of July 1, 1996, through June 30, 1999.

NOTE: The amounts identified to be returned in this finding are duplicative of the amounts to be returned for students who were improperly recruited. Only those amounts not returned as a result of our first finding should be returned to lenders and the Department.

University Comments and OIG Response

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

<u>The University Has Adequately Documented Its Compliance With the 12-Hour Rule</u>

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 followed specific procedures to ensure that the SPGS programs provided the requisite amount of "regularly scheduled instruction, examinations, or preparation for examinations" required by the 12-Hour Rule. The OIG is now attempting to hold the University accountable to specific tracking procedures and other documentation rules created through its audit process.

<u>OIG Response</u>

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 SPGS programs 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 an[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 CFR § 668.24(a)). The regulations require the University to document its compliance with the 12-Hour Rule. 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.

Study Group Meetings Constitute Instructional Activity

The University stated that the SPGS study group meetings fall within the scope of "regularly scheduled instruction, examinations, or preparations for examinations." The regulatory text confirms this conclusion, stating that "instructional time" excludes "activity not related to class preparation or examinations."

OIG 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 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."

Study Group Meetings Were Regularly Scheduled

The University stated that it required students, in the first week of the program, to complete 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. Several other factors clearly indicate that the study group meetings were "regular," "scheduled," and under the supervision of 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. Also, each designated study group session was, by curriculum design, slated to occur between specified meetings with the faculty instructor.

OIG Response

During our preliminary work to gain an understanding of the course and cohort structure, we reviewed 19 study group constitutions. Only 6 of the 19 stated the day, time, and location of the weekly study group meetings. Subsequent to our preliminary work, we conducted a statistical sample and requested that the University provide study group documentation to support the required hours in our sample. The University did not provide any study group constitutions to support these hours. Based on our review of the University's written policies and procedures, review of documentation provided, and interviews with University officials, we determined that the University did not provide adequate assurance that study groups were scheduled to meet the requirements of the 12-Hour Rule.

The University Adequately Monitored Study Group Meeting Attendance

The University stated that it repeatedly informed students in SPGS programs of the mandatory nature of study group attendance. In addition, at the end of each SPGS course, students completed mandatory end-of-course evaluations. 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 ignored them. After dismissing the course module statements describing study group projects, failing to consider the study group constitutions, rejecting the end-of-course evaluations, and ignoring the involvement of Baker faculty and administrators with study group members, the OIG reaches the conclusion that the University did not "ensure that study group meetings were regularly scheduled and occurred." In addition to demanding an unjustified amount of documentation, the OIG is fundamentally mistaken in its claim that the University must "ensure" that students attend each occurrence of study groups. 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 group meetings were "regularly scheduled."

OIG Response

We are not attempting to establish an attendance requirement. The regulations at 34 CFR § 668.24(a)(3) state:

(a) An institution shall establish and maintain on a current basis, any application for title IV, HEA program funds and program records that document –
(3) Its administration of the title IV, HEA programs in accordance with all applicable requirements; …

It is incumbent on the University to demonstrate that it is in compliance with the 12-Hour Rule. 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 the monitoring and oversight of the study teams. Contrary to the University's assertion, we did consider the various forms and evaluations.

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 team meetings in order for study teams 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 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 a strong control. Our review of a sample of student/class combinations indicated that students received passing grades from faculty members without sufficient evidence that the study group hours related to the weekly meetings were scheduled or occurred.

Additional Hours Spent by Students in Preparation for Examinations are Includable Under the 12-Hour Rule

The University stated that some SPGS 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 examinations, although the 12-Hour Rule explicitly permits time spent in "preparation for examinations" to be counted towards compliance.

OIG 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 four hours per week be spent in classroom workshops and four 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 a Notice of Proposed Rulemaking (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 SPGS program had no study days scheduled in lieu of scheduled classes.

There is No Statutory or Regulatory Basis for the OIG's Requirement That the University "Ensure That Study Group Meetings Were Taking Place"

The University stated that the 12-Hour Rule requires only a minimum number of "regularly scheduled" instructional hours. 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. The Department recognized 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." 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 students' actual attendance for the "regularly scheduled instruction" to be counted under the 12-Hour Rule.

OIG 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. The University was required to provide 360 hours of instruction in a minimum of 30 weeks. As with any other regulation, it is the University's responsibility to demonstrate compliance. In this case the University must demonstrate that it scheduled the study group hours and that they occurred. By its own definition of an academic year (which consisted of a mandatory 180 hours of study *group* meetings) the University excluded any additional time *individual* students may have spent in other activities such as research, independent study, internships, special studies, etc. We found no evidence that these activities were regularly scheduled.

The 12-Hour Rule is Widely Acknowledged to be Unworkable and Ill-Suited for Non-Traditional Educational 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. The recently introduced Internet Equity and Education Act of 2001 would effectively eliminate the 12-Hour Rule.

OIG 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.

<u>The Recommended Liability is Based on an Erroneous Methodology and Excludes Significant Amounts of Time That Count Toward Compliance with the 12-Hour Rule</u>

The University stated the OIG failed 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. 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.

<u>OIG Response</u>

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. Our review focused on whether the University had documentation to show that students spent the required four hours per week in these study group meetings.

Background

Baker University was founded in 1858. Baker was accredited at the baccalaureate degree level in 1913. In May 1988, Baker University began a number of new degree programs for working adults that were united within the School of Professional and Graduate Studies. The SPGS offered the following degree programs: Master of Liberal Arts (MLA), Bachelor of Business Administration (BBA), Master of Science in Management (MSM), Master of Business Administration (MBA), Bachelor of Science in Management (BSM), and the Master of Arts in Education (MAED). The SPGS also offered the Bridge program, which consisted of general education courses necessary to prepare students for the BBA program. The Associate of Arts in Business (AAB) program began in August 1997. On February 1, 1996, the University contracted with the Institute for Professional Development (IPD) to provide recruiting and accounting services for certain SPGS programs. Our review covered the BBA, MSM, MBA, BSM, Bridge and AAB programs. The MLA and MAED programs were not included in the contract, and were semester-based; therefore, they were not part of our review. In March 1997, the North Central Association of Colleges and Schools conducted a "focused visit" and concluded the SPGS was performing satisfactorily in the areas reviewed. The focused visit dealt with two specific areas: the completion of a financial work-out plan, and a review to ensure the continuation of academic integrity on all off-campus programs. As of June 2001, the SPGS served 1,470 students from its classroom and office complex in Overland Park, Kansas, and small complexes in Topeka and Wichita, Kansas.

The contract stated that IPD was to provide the following services: (i) recruitment of students, (ii) collection of all tuition and applicable fees, book/material fees, and other fees payable by a student and applicable to the program, (iii) maintenance of the official accounting records, and (iv) consulting services in the area of program management as outlined in the contract. The contract stated that IPD was responsible for preparing promotional literature and providing recruitment representatives. It further stated that IPD was to assist the University with compliance with any legal requirements established in the jurisdiction in which the programs and their related course of study are conducted, in which non-compliance may in any way affect the programs or course of study. The contract required IPD to recruit an average initial enrollment of 16 students per class (cohort group) during each year of the contract. Baker University was not obligated to start any class with an initial enrollment of less than 13 students. The cohort groups were to meet for four hours per week in classroom instruction and predetermined groups of four to five students were to meet weekly for four hours of study group sessions. Classes were to be taken in sequence and generally lasted five weeks.

The University's responsibilities outlined in the contract included maintaining the academic records and information on all students enrolled in the program, and determining the admissibility of all students to the program. The University determined the amount of tuition and fees charged, exercised total jurisdiction over curricula approval, and provided necessary administrative office space on campus for IPD and Baker University personnel involved in the administration of the program.

Students enrolled in SPGS programs received assistance under the Federal Stafford Loan Program, the Federal Pell Grant Program, and the Supplemental Educational Opportunity Grant Program. The U.S. Department of Education reported a 2.3 percent default rate for Baker University for fiscal year 1998.

Objectives, Scope, and Methodology

The objectives of the audit were to determine the University's compliance with the HEA and Title IV regulations in the areas of recruitment of students and student enrollment, and course length. We focused our review on the following areas.

- The University's contract with IPD, and the University's Program Participation Agreement (PPA) with the Department of Education.

- Required hours of instruction in an academic year.

To accomplish our objectives, we reviewed the University's policies and procedures for its SPGS programs, accounting and bank records, and student financial assistance and academic files. We reviewed the University's contract with IPD, IPD's compensation plans for its recruiters, and the University's PPA with the Department. We reviewed the most recent single audit reports prepared by the University's Certified Public Accountants covering the three fiscal years ended June 30, 1997, 1998 and 1999. We also reviewed the program review report prepared by OSFA's Institutional Participation and Oversight Service for the award years 1993-94 and 1994-95. We reviewed the most recent report prepared by the University's accrediting agency. We interviewed University and IPD management officials and staff. We reviewed documentation for two statistically selected study groups, and 60 statistically selected student/class combinations. For the sample of 60, we defined the universe as consisting of 14,258 unique student/class combinations. To achieve a higher level of sampling precision with a smaller overall sample size (reduce variability), we *stratified* the sample of 60 student/class combinations into three separate stratum consisting of 20 student/class combinations from each award year during our scope. Our desired confidence level was 90 percent with a precision of + or – 20 percent (or less). We determined that, if there were 1000 documented hours in the total population, the probability is 96.8 percent *(sampling risk)* that we would have found at least one hour.

To achieve the audit objectives we extensively relied on computer processed data contained in Baker University's POISE system and IPD's Oracle student account activity system. We used data from the Department's National Student Loan Data System (NSLDS) to corroborate the data obtained from the University. We tested the accuracy, authenticity, and completeness of the various data elements by comparing source documents to computer data, and comparing computer data to source documents. Based on these tests and assessments we concluded the data are sufficiently reliable to be used in meeting the audit's objectives.

The audit covered the 1996-97, 1997-98, and 1998-99 award years (July 1, 1996, through June 30, 1999). We performed fieldwork on-site at the University's offices in Baldwin City and Overland Park, Kansas, during the periods September 12–15, 2000; September 19, 2000; December 4, 5, 7, and 20, 2000; and March 26, 2001. We held an exit conference with the

University on August 15, 2001. We conducted the audit in accordance with government auditing standards appropriate to the scope of review described above.

Methodology Used to Determine the Title IV Funds Improperly Disbursed by the University for the Commissioned Sales Finding

We identified total disbursements of $13,612,816 in Federal Stafford loan funds, $257,791 in Pell Grant funds, and $64,688 in Supplement Educational Opportunity Grant (SEOG) funds. The University provided electronic files containing information on SPGS students who received disbursements for Stafford loans, SEOG and Pell Grants during our audit period. We used the information contained in these files and corroborating information extracted from NSLDS to determine the improperly disbursed funds.

Methodology Used to Determine the Title IV Funds Improperly Disbursed by the University for the Course Length Finding

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 should not have disbursed Title IV funds to students during a 90-week academic period that exceeded the maximum annual amounts for an academic year allowed under the Stafford loan and Pell Grant programs.

<u>Determination of Stafford Loan Disbursements in Excess of Annual Loan Limits.</u> We determined the eligible disbursements based on the initial grade level and applicable loan limits. For the two groups described in the following paragraph, we estimated $1,672,276 in Title IV disbursements that exceed the annual limits.

For the Stafford loan estimates, we analyzed disbursements for two separate groups of students identified from files provided by the University. For students in each group, we analyzed loan period start dates and loan disbursements covering a 90-week academic period. The first group consisted of students who received disbursements for loans with loan start dates during the period July 1, 1996, through June 30, 1997, and disbursements for loans with loan start dates during the period July 1, 1997, through June 30, 1998. The second group, which excludes students included in the first group, consisted of students who received disbursements for loans with loan start dates during 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.

<u>Pell Grant Disbursements in Excess of Annual Limits.</u> We identified the Pell funds disbursed to students during our audit period. To determine the amount of Pell funds that a student may receive during 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 were overstated by one-half, or 50 percent. Since the University awarded Pell Grant funds to students according to the number of hours in their cohort schedules, and these schedules did not always consist of 360 instructional hours for an enrollment period, we adjusted the disallowance

percentage downward to reflect the actual number of hours in each cohort's schedule. As a result, the disallowance percentage varied among cohorts. We estimated $108,704 in Pell disbursements exceeded the maximum amount allowed.

Statement on Management Controls

As part of our review, we gained an understanding of Baker University's management control structure, as well as its policies, procedures, and practices for the School of Professional and Graduate Studies, as 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 significant controls in the following categories:

- Data Reliability
- Institutional Eligibility and Student Enrollment
- Institutional Adherence to the Definition of Academic Year

Because of 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 identified significant management control weaknesses which adversely affected Baker University's ability to administer the Title IV programs for its SPGS programs. These weaknesses included incentive-based payments for student enrollment that violated the statutory prohibition on commissioned sales, and inadequate control over the amount of time spent in instruction that violated the 12-Hour Rule. These weaknesses and their effects are discussed in the *Audit Results* section of this report.

Baker University

Comments on the Draft Report

JUN 18 2002

AUDIT SERVICES

THE PRESIDENT

1858

BAKER UNIVERSITY

VIA OVERNIGHT DELIVERY

June 17, 2002

Mr. William Allen
Regional Inspector General for Audit
U.S. Department of Education
Office of Inspector General
10220 N. Executive Hills Blvd., Suite 200
Kansas City, MO 64153-1367

RE: Draft Audit Report; Baker University
(Control Number ED-OIG/A07-A0030)

Dear Mr. Allen:

Attached please find Baker 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,

Daniel M. Lambert
President

Attachment

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BAKER UNIVERSITY'S RESPONSE TO THE DRAFT AUDIT REPORT OF THE U.S. DEPARTMENT OF EDUCATION OFFICE OF INSPECTOR GENERAL (Control Number ED-OIG/A07-A0030)

Baker University (the "University," or "Baker") is a private, not-for-profit, liberal arts institution founded in 1858 and is the oldest university in the State of Kansas. The University's main campus is located in Baldwin City, Kansas, and it also offers adult-learning courses in Overland Park, Topeka, and Wichita, as well as Lee's Summit, Missouri. Affiliated with the United Methodist Church, the University currently serves approximately 2300 students from 28 states and 10 foreign countries. Baker University is accredited by the North Central Association of Colleges and Schools, the National League for Nursing Accrediting Commission, the Commission on Collegiate Nursing Education, the National Association of Schools of Music, the Association of Collegiate Business Schools and Programs, and the National Council for Accreditation of Teacher Education. The University has consistently maintained very low cohort default rates, which have steadily declined in recent years: 3.4 percent in Fiscal Year ("FY") 1997, 2.3 percent in FY 1998, and 1.8 percent in FY 1999. Baker ranks second among all private and public colleges in Kansas for the percentage of undergraduate students accepted to graduate programs, and ninety-eight percent of its graduates are in a professional job or graduate school within six months of graduation.

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 Baker University's School of Professional and Graduate Studies ("SPGS"). The University maintains a contract with an independent outside entity, the Institute for Professional Development ("IPD") for various services related to SPGS academic programs. The issues raised by the Draft Audit Report pertain both to the "Agreement between Baker University and Institute for Professional Development" (the "IPD Contract"), and to the structure of the SPGS academic programs in question. The SPGS 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 SPGS 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 "violated 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 SPGS programs between July 1, 1996 and June 30, 1999. The Draft Audit Report further claims that "the University's academic year for its SPGS programs did not provide 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 SPGS students.[1] 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.

I. NEITHER BAKER 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 SPGS 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 contract "provided for incentive payments to IPD based on success in securing student enrollments for the SPGS 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 Baker University, many of which have variable costs dependant on the number of students enrolled in the SPGS 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 is 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

[1] As the Draft Audit Report notes at page 1, note 1, the Title IV funds at issue under the 12-Hour Rule finding are duplicative of amounts covered by the Incentive Compensation Rule issue.

the IPD Contract.

1. The IPD Contract compensates IPD based on the volume of a broad range of professional services provided to Baker 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 SPGS programs:

- Management consulting and training regarding:
  - Program administration and evaluation;
  - Assessment center organization and management;
  - Student tracking systems development and implementation;
  - Marketing research and management;
  - Student tuition and financial aid accounting;
  - Faculty recruitment and assessment;
  - Ongoing curriculum review and revision;
- Academic quality audits and mock accreditation reviews for SPGS programs;
- Administrative support for all SPGS staff (the majority of which are University faculty and personnel):
  - Office space for SPGS administration;
  - Telephones, copiers, and computers for SPGS administrative offices;
  - Administrative personnel (receptionist, secretaries, etc.) for SPGS administrative offices;
- Acquisition and maintenance of appropriate classroom facilities for SPGS programs;
- Professional development and training activities for University's financial aid staff, student services personnel, and SPGS faculty;
- Feasibility studies concerning potential expansion of SPGS programs;
- Maintenance of accounting records, and financial planning and budgeting, in conjunction with the University's Office of Financial Services.

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 4-5. The OIG wrongly implies that recruitment and tuition collections constituted IPD's only functions with respect to the SPGS 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 SPGS 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 SPGS programs," and for no other functions whatsoever. Id. The IPD Contract, however, reflects that the allocation of SPGS revenues is based upon a wide range of non-enrollment related academic and administration functions, in addition to the limited items identified in the Draft Audit Report. If the OIG auditors unintentionally overlooked these additional IPD responsibilities in the course of the their review, the audit procedures were incomplete and therefore flawed. However, if the auditors were aware of these additional IPD services and chose to ignore them, the Draft Audit Report is flawed in a manner that raises questions about the impartiality of the 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 SPGS 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 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 and regulatory history to support the Incentive Compensation Rule as a basis for the Department to regulate institutions' routine business arrangements with outside vendors where services are contracted for at a set rate of compensation based on the volume of services provided, such as the contract between Baker University and IPD.[2]

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

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 SPGS students. The magnitude of IPD's various functions and obligations under the contract depends in substantial part upon how many students enroll in the SPGS 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 SPGS 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.[3]

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

[3] 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.

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 Baker University, whether by IPD for the SPGS 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 addition, the University's FY 1999 cohort default rate is only 1.8 percent. This extraordinarily low default rate is conclusive proof that the University did not admit unqualified students into its SPGS 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.

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 Baker University 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.[4] Indeed, for all of the reasons presented in this submission, this University and many others like it reasonably believed the opposite.[5] And in fact, as discussed

[4] 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." Although the Department subsequently presented draft regulatory amendments concerning incentive compensation to a negotiated rulemaking committee, the negotiated rulemaking process failed to reach consensus. 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.

[5] 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

below, the Department's recent statements during negotiated rulemaking verify the University's reasonable belief.[6] 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 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.

Perhaps 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 the prohibition's scope. That draft provided specific examples of "[a]ctivities and arrangements that an institution may carry out without violating" the prohibition, including with respect to revenue-sharing:

> Payments to third parties, <u>including tuition sharing arrangements</u>, 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 position 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 Baker based upon

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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.

[6] See note 4.

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.

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

The Draft Audit Report erroneously asserts at page 5 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 SPGS programs, the University must return all Title IV funds that were disbursed on behalf of students enrolled in the SPGS programs." On these grounds, the OIG asserts that an exaggerated amount -- $13,935,295 -- representing the principal amount of all Title IV loans and grants received by SPGS 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 SPGS-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 nearly fourteen million dollars, representing all federal funds received by students enrolled in the SPGS 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.

- The University and its SPGS 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 SPGS 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 SPGS students.

- Nowhere does the Draft Audit Report allege or imply that any SPGS 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 SPGS 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 SPGS students.

- 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 SPGS 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 SPGS 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.[7]

- 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 extraordinarily low cohort default rates for the last three years. The University's rates for fiscal years 1997, 1998, and 1999 were 3.4 percent, 2.3 percent, and 1.8 percent, respectively. 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, Baker 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 SPGS students, making all final determinations on SPGS admissions, and establishing tuition and fees for programs. See IPD Contract, pages 12-14. The University also exercised exclusive jurisdiction over curricula content and approval, and retained authority over instructional personnel for the SPGS programs. Id. at page 14. However, IPD was responsible to "pay and be responsible for the cost for all services to be rendered by IPD under the terms of [the] Agreement including but not limited to payroll." Id. at page 17.

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:

[7] The Draft Audit Report further overstates the value of Title IV funds awarded to SPGS students by apparently failing to consider any amounts that may have been refunded, following the initial disbursement, because of changes in students' enrollment status.

* * *

IPD Recruiter Salaries Do Not Violate The Incentive Compensation Rule

The Draft Audit Report asserts at page 5 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 [SPGS] programs." Yet, in describing the IPD salary plan, the Draft Report states that "[r]ecruiters were assigned a salary within the parameters of performance guidelines (i.e., knowledge of basic policies and procedures, organization and communication skills, and working relationships)." The guidelines cited by the OIG are not related to a recruiter's success in securing enrollments – e.g., a recruiter may exhibit any or all of the aforementioned qualities without recruiting a threshold number of students. Thus, the Draft 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. <u>The Incentive Compensation Rule does not prohibit salary based on success in securing enrollments.</u>

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

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

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

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

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

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

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

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

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

The Secretary has not published an interpretation of the Incentive Compensation Rule that explicitly prohibits basing recruiter salaries on success in securing enrollments. Neither the notice of proposed rulemaking nor the preamble to the final regulations address the issue of "salary" based on success in securing enrollments. 59 Fed. Reg. 22348 (Apr. 29, 1994); 59 Fed.

Reg. 9526 (Feb. 28, 1994). Although the Secretary indicated that he might, at some point, publicly clarify what he considers acceptable under the statute and regulation (see 59 Fed.Reg. at 9539), he has not yet done so. Accordingly, the Secretary has not published any explicit prohibition with respect to recruiter salaries, nor any interpretation contrary to that set forth in the aforementioned Congressional Conference Report.

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

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

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

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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. BAKER UNIVERSITY'S PROFESSIONAL AND GRADUATE STUDIES PROGRAMS COMPLY WITH THE 12-HOUR RULE.

The University demonstrates that its SPGS programs fully satisfied the 12-Hour Rule and that such compliance is fully and appropriately documented. The additional documentation sought by the OIG (hereinafter referred to as the "OIG's purported documentation rule") 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 SPGS programs.

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

The SPGS 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 SPGS programs 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 SPGS students. The Draft Audit Report, however, disallows all study group hours because they fail to satisfy the OIG's purported documentation rule. As a result, the OIG claims that the SPGS programs provide only one-half of the instructional time required by the 12-Hour Rule.

The Department has already concluded that "[t]here is no meaningful way to measure 12 hours of instruction"[8] 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[9] altogether, proposed its elimination to a negotiated rulemaking committee earlier this year. The OIG is now attempting to hold the University accountable to specific attendance tracking procedures and other documentation rules created through its audit process. 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

[8] U.S. Department of Education, Office of Postsecondary Education, "Report to Congress on the Distance Education Demonstration Programs" (January 2001), at page 24. This report and its conclusions regarding the 12-Hour Rule and nontraditional educational programs are discussed in greater detail infra.

[9] 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).

the Draft Audit Report, the University implemented various policies and followed specific procedures to ensure that the SPGS programs provided the requisite amount of "regularly scheduled instruction, examinations, or preparation for examinations" required by the 12-Hour Rule, published at 34 C.F.R. § 668.2(b)(2)(ii)(B).

1. Study group meetings constitute instructional activity.

The SPGS 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.[10]

2. Study group meetings were regularly scheduled.

The curriculum module for each SPGS course expressly requires students to attend study group meetings in order to discuss course material, prepare graded assignments, and share learning resources.[11] 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 SPGS programs, faculty informed the students of the study group meeting requirements, and presented written materials to students reiterating this requirement. 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 and reviewed their contents. 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 the supervision of University faculty. The specific tasks to be performed

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[10] The Draft Audit Report does not seem to dispute that study group meetings constitute instructional activity, however the OIG excludes all of the SPGS study group meetings from its 12-Hour Rule calculations because they fail to satisfy the OIG's purported documentation rule.

[11] Promotional and admissions materials, including written brochures and the SPGS applications, repeatedly emphasized the study group component of the SPGS programs, and that study group activities would comprise at least four hours of each week's total course time.

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. Also, 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.

3. <u>The University adequately monitored study group meeting attendance.</u>

The University repeatedly informed students in SPGS programs of the mandatory nature of study group attendance. This was presented during pre-enrollment information sessions, during the first class with a faculty member, and restated yet again in the student handbook and course catalog. In addition, at the end of each SPGS course, students completed mandatory End-of-Course evaluations. 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 ignored them.

The Draft Audit Report also ignores the fact that faculty and staff spent a great deal of time resolving conflicts within study group memberships or providing academic direction and guidance. For example, if a student did not regularly attend the mandatory study group meetings, a faculty member would first intervene at the request of other study group members. However, if a student continued to 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 SPGS program altogether. After dismissing the course module statements describing study group projects, failing to consider the Study Group Constitutions, rejecting the End-of-Course evaluations, and ignoring the involvement of Baker faculty and administrators with study group members, the OIG reaches the 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 evidence.

In addition to demanding an unjustified amount of documentation, the OIG is fundamentally mistaken in its claim that the University must "ensure" that students attend each occurrence of study groups. 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 we contend the University has adequately fulfilled), 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 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.

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 for instructional time to count towards 12-Hour Rule compliance.[12] 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 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.[13]

[12] "[SPGS] students were required to meet for four hours per week in regular workshops and an additional four hours per week in study groups.... It was the University's policy was that an instructor be present at regular classes ... but the policy for study group attendance was at the discretion of the faculty member." Draft Audit Report at 8. These 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.

[13] 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 SPGS course curriculum, such issues are plainly beyond the OIG's scope of authority.

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

Some SPGS 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. 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.

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 SPGS courses 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."

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 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 Adult and Professional Studies programs. The section of the Higher Education Act concerning the minimum period of academic instruction for Title IV eligibility 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).[14] 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."[15]

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.

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 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

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[14] 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).

[15] 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).

there is no distinction between instructional time and 'home work.'"[16] The University's SPGS 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 SPGS 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 Federal Register this summer.[17] We therefore question the purpose of the OIG applying a rule that the Department itself calls "unworkable" and believes is totally unnecessary. 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 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, supervised by a faculty member, or take place in closely-monitored University facilities. Students' grades for SPGS 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.

[16] 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.

[17] 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.

CONCLUSION

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

Respectfully submitted,

BAKER UNIVERSITY
Dr. Daniel M. Lambert, President

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