

October 2010

HIGHER EDUCATION

Stronger Federal Oversight Needed to Enforce Ban on Incentive Payments to School Recruiters



GAO

Accountability * Integrity * Reliability

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Abbreviations

FTC	Federal Trade Commission
HEA	Higher Education Act of 1965, as amended
OIG	Office of Inspector General
SEC	U.S. Securities and Exchange Commission

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United States Government Accountability Office
Washington, DC 20548

October 7, 2010

The Honorable Tom Harkin
Chairman
The Honorable Michael B. Enzi
Ranking Member
Committee on Health, Education, Labor, and Pensions
United States Senate

The Honorable George Miller
Chairman
The Honorable John P. Kline
Ranking Member
Committee on Education and Labor
House of Representatives

In 1992, Congress banned schools participating in federal student aid programs from paying commissions, bonuses, or other financial incentives to individuals based on their success in enrolling students or securing their financial aid.¹ The ban applies to all postsecondary schools, including private for-profit, public, and private nonprofit schools. Congress instituted this incentive compensation ban to eliminate deceptive recruiting practices and to protect federal student aid funds from fraud and abuse.² However, we recently found evidence of deceptive or fraudulent recruitment practices at certain postsecondary schools in which school officials misrepresented programs or encouraged students to falsify their financial aid applications to obtain federal student aid.³ Questions have been raised about whether schools are consistently acting

¹Generally, the incentive compensation ban applies to schools participating in federal student aid programs authorized under Title IV of the Higher Education Act of 1965 (HEA), as amended (20 U.S.C. § 1001 et seq.). The ban on incentive payments was added to HEA by the Higher Education Amendments of 1992, Pub. L. No. 102-325, § 490 (a)(3).

²The federal government provided over \$100 billion dollars in grants and loans to fund students' higher education in the 2008-2009 school year. If students default on their federal loans, the government and the taxpayers—not the schools—are left with the costs of the unpaid loans.

³GAO, *For-Profit Colleges: Undercover Testing Finds Colleges Encouraged Fraud and Engaged in Deceptive and Questionable Marketing Practices*, [GAO-10-948T](#) (Washington, D.C.: Aug. 4, 2010).

in the best interest of students during the recruitment process, and whether the federal investment in student aid is adequately protected.

The U.S. Department of Education (Education) is responsible for monitoring schools participating in federal student aid programs and enforcing compliance with the incentive compensation ban. Education has the authority to assess fines or take other actions against schools found violating the ban.

In the Higher Education Opportunity Act, Congress mandated that GAO conduct a study on Education's oversight of the incentive compensation ban.⁴ In February 2010, we issued a report which provided information on incentive compensation violations substantiated by Education from January 1998 through December 2009, the nature of these violations, and the names of the institutions involved.⁵ This report provides additional information on Education's oversight of the ban during this time period. Specifically, we examined (1) how Education monitors schools for potential violations of the incentive compensation ban, and (2) the extent to which Education has used its authority to enforce the incentive compensation ban.

On September 9, 2010, we briefed your staff on the results of our study. This report formally conveys the information provided during the briefing (see appendix I for the briefing slides). We found:

- Education has processes to monitor schools for potential violations, but its methods to detect violations and track monitoring activities are limited.
- Education uses annual independent audits, program reviews, and other processes to monitor schools for potential violations, but primarily relies on the audits. Annual audits are conducted by independent auditors who evaluate school compliance with all federal student aid rules, including the ban on incentive compensation for recruiters.

⁴Pub. L. No. 110-315 § 1124 (2008).

⁵GAO, *Higher Education: Information on Incentive Compensation Violations Substantiated by the U.S. Department of Education*, [GAO10-370R](#) (Washington, D.C.: February 2010). We defined substantiated violations as those cases in which a violation of the incentive compensation ban was noted in an Education final determination letter by December 10, 2009, the most recent information available at the time of this study.

-
- Weaknesses in the audit process may limit detection of potential incentive compensation violations. For example, we found that independent auditors did not always document testing of school compliance with the ban or follow up on prior year audit findings to determine if past problems had been corrected or were still occurring. Auditors told us that Education's Office of Inspector General audit guide requires that auditors test for incentive compensation compliance, but does not provide specific instructions on how to do so.
 - Program reviews conducted by Education staff supplement the annual audits and focus on high-risk schools; however, Education's current tracking system does not identify all program reviews that examine incentive compensation. As a result, Education cannot identify the extent of incentive compensation problems, track monitoring actions over time, or assess and improve the effectiveness of its program reviews. In addition, Education cannot determine if it has appropriately targeted resources to review high-risk schools and dedicated sufficient resources to monitor schools for violations.
 - Education has used some of its authority to enforce the incentive compensation ban, but its efforts may be hindered by its own penalty policies and practices.
 - Between 1998 and 2009, Education resolved most incentive compensation cases by requiring corrective actions or reaching settlement agreements, and did not limit, suspend, or terminate any school's access to federal student aid.
 - Education changed its enforcement policy in 2002, which resulted in an increased burden on Education to prove a violation and lessened associated financial penalties (fines and settlement payments). As a result, it became more difficult for Education to prove a school violated the incentive compensation ban and schools ultimately paid smaller penalties.
 - Education officials shared with us internal guidance that is used to determine fines and settlement payments for incentive compensation cases. Internal guidance for imposing fines and settlement payments establishes caps on total penalty amounts, although related regulations do not have such caps. Education officials have stated that the agency

has not always used the guidance to determine fines and settlement payments.

- Education's varying approaches for determining fines and settlement payments could lead to inconsistent treatment of schools without adequate justification for the differential treatment. For example, some schools were fined for incentive compensation violations, while others were not. In one case, Education withdrew an initiated school fine of over \$2 million dollars, and case documentation did not reveal the reason for the fine withdrawal.

In order to strengthen Education's monitoring and enforcement of the incentive compensation ban and to help protect students and the federal investment in their education, we are recommending that the Secretary of Education:

- Coordinate with Education's Office of Inspector General to strengthen suggested procedures provided to auditors for auditing and reviewing school compliance with the ban.
- Track the total number of program reviews it conducts, specifically looking at incentive compensation issues in order to improve Education's ability to target its resources to high-risk schools and monitor schools for violations.
- Update the guidance used to set fines and settlement payments to establish appropriate financial penalties, and apply the guidance when determining fines and settlement payments for incentive compensation cases.

To address our research questions, we reviewed Education's policies, procedures, and guidance; examined incentive compensation case documentation from 1998 through 2009; reviewed prior GAO and OIG higher education reports, relevant laws and regulations, and standards for internal controls in the federal government; analyzed Education's enforcement data; and interviewed officials from Education, Education's Office of Inspector General, associations representing various school sectors and students, and selected independent auditors who conduct annual school audits. We selected audit firms that conduct both a low and high volume of audits, as well as audits at private for-profit, public, and private nonprofit schools. To assess the reliability of Education's enforcement data, we (1) examined the data; (2) compared the data to available program review, audit, and settlement documentation; and (3)

interviewed agency officials knowledgeable about the data. We determined that the data are sufficiently reliable for the purposes of this report. For more detailed information on our scope and methodology, please see appendix III.

We conducted our work from December 2009 through October 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Agency Comments and Our Evaluation

We provided a draft copy of this report to the Department of Education for review and comment. Education concurred with our recommendations and said it would take several steps to implement them. The full text of Education's comments is reprinted in appendix IV.

Education also provided background information regarding its enforcement efforts, stating it implemented standard procedures in 2006 to help ensure its action on fines was consistent. We considered these 2006 procedures in the course of our work; however, they did not focus on determining fine and settlement payment amounts and, as such, did not ensure enforcement efforts were fair and appropriate. Education also stated that in considering fines for some cases, it determined no action was appropriate because the violations were minor. While there have been some incentive compensation cases with minor violations which may not have warranted fine action, we found evidence of other cases with significant violations which brought no fine action. For example, Education withdrew a fine against a company that paid over \$350,000 in bonuses to recruiters for enrolling 4,750 students, as we note in our briefing slides (see appendix I).

Education also emphasized the importance of using professional judgment to determine a fine or settlement amount. Professional judgment can and should be one factor in determining a fine or settlement amount, as we note in our briefing slides. However, it is also important to have guidance on an appropriate range for fine and settlement payments, and a process for weighing different factors to reach a final payment amount. Such guidance would help ensure a clear understanding of how Education determines financial penalties for incentive compensation cases.

Lastly, Education reported it has faced many challenges in its efforts to enforce the incentive compensation ban. In particular, the language in an Education regulation, known as the first safe harbor, has made it difficult to enforce the ban. We acknowledged these challenges in our briefing slides.

We are sending copies of this report to relevant congressional committees, the Secretary of Education, and other interested parties. In addition, this report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staffs have any questions about this report, please contact me at (206) 287-4820 or iritanik@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix V.



Katherine M. Iritani
Acting Director
Education, Workforce, and Income Security Issues

Appendix I: Briefing Slides



HIGHER EDUCATION: Stronger Federal Oversight Needed to Enforce Ban on Incentive Payments to School Recruiters

Briefing to Congressional Committee Staff:

**Health, Education, Labor, and Pensions
United States Senate**

**Education and Labor
United States House of Representatives**

September 2010



Overview

- Introduction
- Research Questions
- Scope and Methodology
- Summary of Key Findings
- Background
- Findings
- Conclusions
- Recommendations



Introduction

- In 1992, Congress banned schools from paying commissions, bonuses, or other financial incentives to individuals based on their success in enrolling students or securing financial aid for them.*
- The ban applies to all postsecondary schools participating in federal student aid programs, including private for-profit, public, and private nonprofit schools.
- Congress instituted this incentive compensation ban to eliminate deceptive recruiting practices and to protect federal student aid funds from fraud and abuse.**

* Higher Education Amendments of 1992, Pub. L. No. 102-325 § 490(a)(3).

** The federal government provided over \$100 billion dollars in grants and loans to fund higher education for students in the 2008-2009 school year. If students default on their federal loans, the government and the taxpayers—not the schools—are left with the costs of the unpaid loans. Generally, the incentive compensation ban applies to schools participating in federal student aid programs authorized under Title IV of the Higher Education Act of 1965, as amended (20 U.S.C. § 1001 et seq.).



Introduction

- However, we recently found evidence of fraudulent or deceptive recruitment practices at 15 postsecondary schools we visited.* For example:
 - Some school officials encouraged prospective students to falsify their financial aid applications to obtain federal student aid.
 - Other school officials misled potential students about the cost of the programs and exaggerated the salaries they could earn after graduating.
- Questions have arisen about whether schools are consistently acting in the best interest of students during the recruitment process, and whether the federal investment in student aid is adequately protected.

* GAO, *For-Profit Colleges: Undercover Testing Finds Colleges Encouraged Fraud and Engaged in Deceptive and Questionable Marketing Practices*, GAO-10-948T (Washington, D.C.: Aug. 4, 2010).



Introduction

- The U.S. Department of Education (Education) is responsible for monitoring schools and enforcing compliance with the incentive compensation ban.
 - Education has the authority to assess fines or take several other actions against schools found violating the ban.
- In the Higher Education Opportunity Act, Congress mandated that GAO study Education's oversight of the incentive compensation ban.*
 - In February 2010, we issued a report on incentive compensation violations substantiated by Education from January 1998 through December 2009, the nature of these violations, and the names of the institutions involved, as required in the mandate.**
- This review provides additional information on Education's oversight of the ban during the same time period.

* Section 1124 of the Higher Education Opportunity Act, Pub. L. No. 110-315, Aug. 14, 2008.

** GAO, *Higher Education: Information on Incentive Compensation Violations Substantiated by the U.S. Department of Education*, GAO-10-370R (Washington, D.C.: Feb. 23, 2010). We defined substantiated violations as those cases in which a violation of the incentive compensation ban was noted in an Education final determination letter by December 10, 2009, the most recent information available at the time of the study.



Research Questions

1. How does Education monitor schools for potential violations of the incentive compensation ban?
2. To what extent does Education use its authority to enforce the incentive compensation ban?



Scope and Methodology

To answer these questions, we:

- reviewed Education's policies, procedures, and guidance;
- reviewed incentive compensation case documentation from 1998 through 2009;*
- interviewed officials from Education, Education's Office of Inspector General (OIG), independent auditors who conducted annual school audits, and associations representing various school sectors and students;
- reviewed prior GAO and OIG higher education reports, relevant federal laws and regulations, and standards for internal controls in the federal government; and
- analyzed Education's enforcement data.

We determined the data reviewed to be sufficiently reliable for the purposes of this report.

We conducted our work from December 2009 through October 2010 in accordance with generally accepted government auditing standards.

* Congress mandated that our review of Education's enforcement activities focus on Education's actions since 1998.



Summary of Key Findings

1. Education has processes to monitor schools for potential violations, but its methods to detect violations and track monitoring activities are limited.
2. Education has used some of its authority to enforce the incentive compensation ban, but its efforts may be hindered by its own penalty policies and practices.

Background



The Incentive Compensation Ban and Regulations

The ban prohibits schools that receive federal student aid funds from providing “.....any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to any persons or entities engaged in any student recruiting or admissions activities or in making decisions regarding the awards of student financial assistance....” *

- Several times since the ban’s enactment in 1992, Education has issued regulations regarding incentive compensation. For example,
 - In 2002, Education published regulations—commonly referred to as safe harbors—that allow for 12 compensation arrangements schools can use without violating the ban.** (For more information, see appendix II.)
 - In June 2010, Education proposed new regulations, which would eliminate the safe harbors.*** Education expects to publish the final rules by November 1, 2010.

* 20 U.S.C. § 1094(a)(20). Persons or entities refers to school employees or third-party contractors hired by a school; the ban does not apply to the recruitment of foreign students residing in foreign countries who are not eligible to receive federal student aid from the U.S. government.

** 67 Fed. Reg. 67,048 (Nov. 1, 2002).

*** 75 Fed. Reg. 34,806 (June 18, 2010).

Background



Department of Education's Oversight Authority

- Under its oversight authority, Education monitors and enforces school compliance with federal student aid programs, including the statutory ban against incentive compensation.
 - Education and Education's OIG have policies, procedures, and guides directed to Education staff and external parties, such as independent auditors, responsible for monitoring school compliance with laws, regulations, and program requirements.
- As part of its enforcement authority, Education can take a variety of actions to resolve incentive compensation cases identified through its monitoring activities.

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Background



Types of Enforcement Actions

Pursuant to its oversight authority, Education may, among other actions:

- require that a school take corrective action;
- reach a settlement agreement with a school;*
- identify liabilities requiring repayment of improperly awarded federal student aid funds;**
- assess fines;*** or
- limit, suspend, or terminate a school's participation in federal student aid programs.***

*Often, the settlements state that the agreements do not constitute an admission of noncompliance or wrongdoing; however, the settlements usually include a payment from the school to Education. We refer to settlement cases as "involving potential incentive compensation problems."

**If Education identifies a liability for an incentive compensation violation at a school, the school is required to repay Education all the federal student aid received for each student improperly recruited as a result of incentive payments made to recruiters.

***20 U.S.C. § 1094(c) and 34 C.F.R. Part 668, Subpart G.



Finding 1: Monitoring for Incentive Compensation Violations

Education Has Processes To Monitor Schools For Potential Violations, but Its Methods To Detect Violations and Track Monitoring Activities Are Limited





- Education uses annual independent compliance audits, program reviews, and other processes to monitor schools for potential violations, but primarily relies on the audits to identify these violations.*
- Weaknesses in the auditors' implementation of the compliance audit process may limit detection of potential incentive compensation violations.
- Program reviews supplement the annual compliance audits and focus on high-risk schools; however, Education's current tracking system does not identify all program reviews that examine incentive compensation.

* Annual audits are required of all schools participating in federal student aid programs and are performed by independent auditors who examine a school's finances and compliance with Education requirements. See 20 U.S.C. § 1094(c)(1) and 34 C.F.R. § 668.23. Program reviews are conducted by Education officials.



Monitoring: Processes Used

Education Uses Several Monitoring Processes to Identify Violations

Activity	Conducted by	Focus of monitoring
 Annual Independent Compliance Audits	Independent Auditors	Evaluate compliance with all federal student aid program requirements and review any violations from prior years.*
 Program Reviews	Education Staff	Evaluate compliance with all requirements (a general review) or specific federal student aid program requirements (a focused review)*
 Office of Inspector General Audits	Office of Inspector General (OIG) staff	Evaluate compliance with specific federal student aid program requirements*
 Qui tam lawsuits** (under False Claims Act)	Private Citizens (i.e., school employees)	Legal processes used to determine if a potential incentive compensation compliance problem has occurred

Source: GAO analysis of regulations and Education documentation.

* For the purposes of this report, we focus on compliance with the incentive compensation ban, one of the eligibility requirements for federal student aid program participation.

** The qui tam provision of the False Claims Act allows private citizens with knowledge of government funds inappropriately claimed by schools to file a lawsuit on the government's behalf and receive a portion of any penalties imposed. See 31 U.S.C. § § 3729-3733.



Monitoring: Processes Used

Education Mainly Relies on Annual Independent Compliance Audits to Identify Violations

- Independent compliance audits occur on an annual basis and are required of all schools that receive federal student aid.*
 - As part of the audit, a review of the school's compliance with the incentive compensation ban is required.
- In contrast, other monitoring processes occur less frequently and target certain schools.
 - Education officials told us program reviews are conducted periodically and only occur at high-risk schools.
 - OIG audits are also done periodically and target schools based on complaints and other information.
 - Qui tam lawsuits have no set frequency and occur when private citizens sue schools on behalf of the government for incentive compensation violations.

*Schools that disburse less than \$200,000 in federal student aid funds for 2 consecutive years and meet other conditions may have their audit submission waived for 3 years. The school must then submit a compliance audit covering each year in the period and a financial statement audit for the last year of the waiver period. See 20 U.S.C. § 1094(c)(1)(A)(iii) and 34 C.F.R. § 668.27.



Monitoring: Weaknesses in Audits

Independent Auditors Have Not Always Adequately Tested for Incentive Compensation Violations

- Annual independent compliance audits did not detect incentive compensation issues at 32 of the 53 schools that were identified—through program reviews or other infrequent monitoring processes—to have problems between 1998 and 2009.*
 - Compliance audits should have identified problems at half of these 32 schools if auditors followed a requirement in the audit guide to review school contracts regarding student recruitment.**
- Officials from Education’s OIG, as well as independent auditors and Education personnel, told us that the quality of annual independent audits varies from auditor to auditor.

*See GAO-10-370R for additional information on these 53 schools.

** Sixteen schools contracted with the Institute for Professional Development to recruit students and paid the Institute based on the number of students recruited. Schools and service providers named in this report have previously been identified in SEC filings, OIG reports to Congress, legal filings, or prior GAO reports.



Monitoring: Weaknesses in Audits

Independent Auditors Have Not Always Adequately Tested for Incentive Compensation Violations (cont'd)

- Education's OIG reviews the quality of select independent compliance audits each year and has identified deficiencies in the audits.*
- Our analysis of the OIG reviews found that independent auditors did not always document whether they had examined compensation practices at schools.
 - For example, 11 percent of the independent compliance audits reviewed between 2007 and 2009 did not document compliance testing for incentive compensation.
- In addition, independent auditors did not always show whether they had followed up on findings from prior audits to determine if past problems had been corrected or were still occurring.
 - For example, 12 percent of the compliance audits also failed to adequately identify and obtain required information on any prior problems at a school, which could include prior incentive compensation violations.**

*The reviewed compliance audits are not randomly selected. Accordingly, the results cannot be generalized to the entire population of audits.

** Some of the reviewed compliance audits had both deficiencies.



Monitoring: Weaknesses in Audits

Education's Suggested Procedures for Conducting Audits are Limited

- Procedures in Education's OIG audit guide for independent auditors require that auditors test for incentive compensation compliance and suggest a review of payroll and other disbursement records, but auditors told us the procedures do not specify how to conduct this test.
- Education's lack of specific suggested procedures contrasts with best practices identified by GAO and others for providing information to independent auditors. For example, these best practices if applied to Education's procedures would suggest:
 - providing specific requirements and examples to assist independent auditors in their work,* and
 - developing detailed procedures and techniques to carry out agency objectives and communicating this information to independent auditors who help ensure school compliance.**

* See President's Council on Integrity and Efficiency, *Report on the National Single Audit Sampling Project*, (June 2007) and GAO, *Single Audit Opportunities Exist to Improve the Single Audit Process and Oversight*, GAO-09-307R (Washington, D.C.: Mar. 13, 2009).

**See internal control standards in GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999) and GAO-01-1008G. Page 16



Monitoring: Weaknesses in Audits

Education's Suggested Procedures for Conducting Audits are Limited (cont'd)

- Independent auditors told us the suggested procedures do not specify how to evaluate compliance with the incentive compensation ban and have not been updated since 2000. They said additional information would be helpful, such as:
 - Education-recommended minimum standards for how to evaluate compliance, which would help ensure that the auditor fully understands a school's compensation plan and selects a random and appropriate sample of payroll records to review;
 - additional information clarifying which school employees are covered by the ban;
 - examples of "red flags" that suggest an auditor should investigate further, such as bonuses being paid at the end of a recruiting cycle; and
 - examples of additional school records an auditor should review to ensure compliance with the incentive compensation ban.
- Independent auditors also said it would be helpful to have the guide updated when policy and regulatory changes occur.
- Education has provided more detailed instructions along these lines for other compliance issues, but independent auditors told us Education has not done so for incentive compensation issues.



Monitoring: Limitations in Tracking

Education’s Program Reviews Supplement Audits, but the Agency Does Not Know How Many Are Done for Incentive Compensation Issues

- In addition to the annual compliance audits, Education conducts program reviews of select schools.
- While Education’s data system captures the total number of program reviews conducted, Education officials told us it does not identify the areas, such as incentive compensation, examined in the reviews.*
- Because program reviews can cover a range of topics and do not always focus on incentive compensation issues, Education is not able to identify the number of program reviews that have examined schools for potential incentive compensation violations.

*Education uses the Postsecondary Education Participants System (PEPS) data system to track monitoring and enforcement activities. An Education official told us that updates to the PEPS data system have occurred in the past when new monitoring needs developed.



Monitoring: Limitations in Tracking

Education's Program Reviews Supplement Audits, but the Agency Does Not Know How Many Are Done for Incentive Compensation Issues (cont'd)

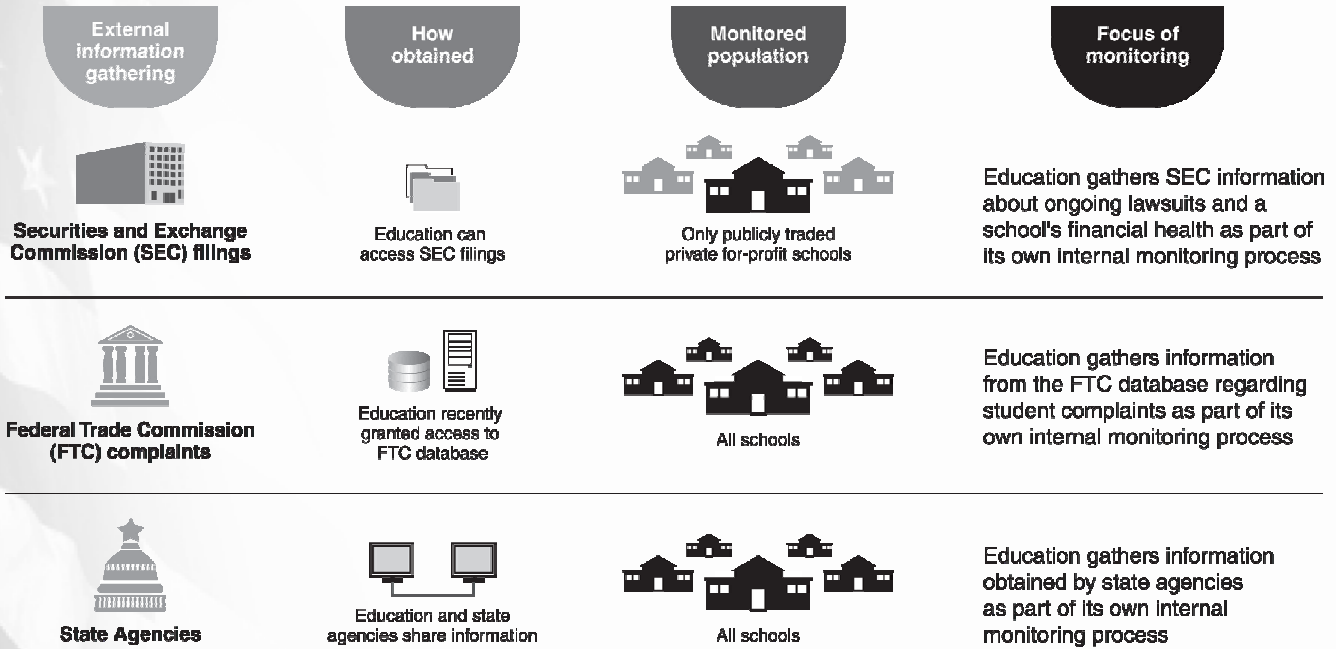
- Education's inability to identify all program reviews that have examined incentive compensation issues presents challenges to ensuring efficient and effective monitoring. Specifically:
 - Without such data, Education cannot identify the extent of incentive compensation problems, track monitoring actions over time, or assess and improve the effectiveness of the program reviews.
 - In addition, Education cannot determine if it has appropriately targeted resources to review high-risk schools and dedicated sufficient resources to monitoring schools for violations.
- According to best practices established by GAO, federal agencies should ensure that they capture information needed to fulfill their responsibilities.*

* See internal control standards in GAO/AIMD-00-21.3.1 and GAO-01-1008G.



Monitoring: Information from External Agencies

Education Staff Also Gather Information From Other Federal and State Agencies to Monitor Schools*



Source: GAO analysis of regulations and Education interviews.

* Education has used a working group and other outreach to promote collaboration among these agencies.



Monitoring: Information from External Agencies

Coordination with the SEC, FTC, and States Has Not Enhanced Education’s Ability to Identify Incentive Compensation Violations

- While Education personnel look at information gathered from the SEC, FTC, and states during the program review process, Education officials told us the information to date has not assisted with specific incentive compensation cases. For example,
 - Complaints in the FTC database have not included new information about potential incentive compensation violations, according to officials.

- Education officials also noted that the external information has sometimes duplicated information Education already has. For example,
 - They told us Education personnel are usually aware of incentive compensation-related qui tam lawsuits against schools before collecting this information from the SEC.



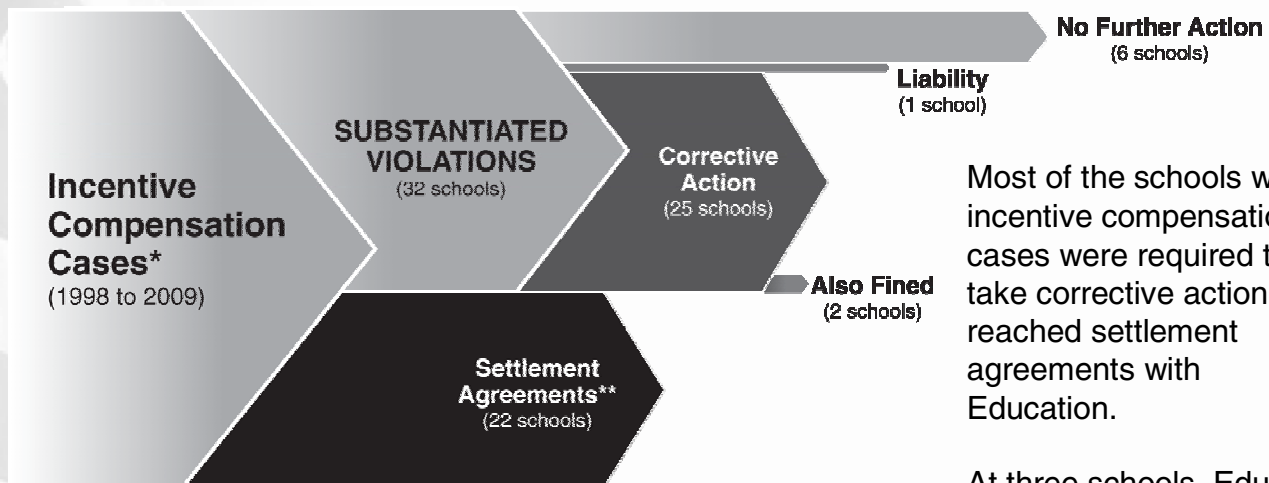
Finding 2: Enforcement of the Incentive Compensation Ban
Education Has Used Some Of Its Authority To Enforce The Incentive Compensation Ban, but Its Efforts May Be Hindered By Its Own Penalty Policies and Practices

- Between 1998 and 2009, Education resolved most incentive compensation cases by requiring corrective actions or reaching settlement agreements, and did not limit, suspend, or terminate any school’s access to federal student aid.
- Education changed its enforcement policy in 2002, which resulted in an increased burden on Education to prove a violation and lessened financial penalties.
- Education’s internal guidance for imposing fines and settlement payments establishes caps on total financial penalties whereas Education’s regulations do not.
- Education’s varying fine and settlement practices could lead to inconsistent treatment of schools.



Enforcement: Resolution of Cases

Between 1998 and 2009, Education Resolved Most Incentive Compensation Cases with Corrective Action or Settlement Agreements



Most of the schools with incentive compensation cases were required to take corrective action or reached settlement agreements with Education.

At three schools, Education imposed fines or found the school liable for misspent federal student aid funds.***

*A total of 53 schools had incentive compensation cases. One school had a substantiated incentive compensation violation and reached a settlement with Education to resolve a separate incentive compensation case. This school is counted in both the substantiated violations and in the settlement agreements.
 **After a school settles an incentive compensation case, like other schools, it is subject to subsequent annual audits that test compliance with the incentive compensation ban.
 ***All financial payments to resolve incentive compensation cases were collected by Education and directed to accounts at the U.S. Treasury.



Enforcement: Resolution of Cases

For Most of the 32 Schools with Substantiated Violations, Education Required Corrective Action

- At 25 of the 32 schools with substantiated violations, Education required schools to take corrective action.
 - Corrective action included ending bonus payments to recruiters for reaching enrollment targets, and ending referral fees to students.
 - 2 of these 25 schools were also required to pay a fine as a penalty, with fines for both totaling \$64,000.

- At 1 of the 32 schools, Education identified a liability of over \$187 million in misspent student aid funds.*
- At 6 of the remaining schools with substantiated violations, no further enforcement action was imposed, typically because the school had closed.**



*Computer Learning Center closed and filed for bankruptcy and Education recouped \$16,254,437 of the total liability.

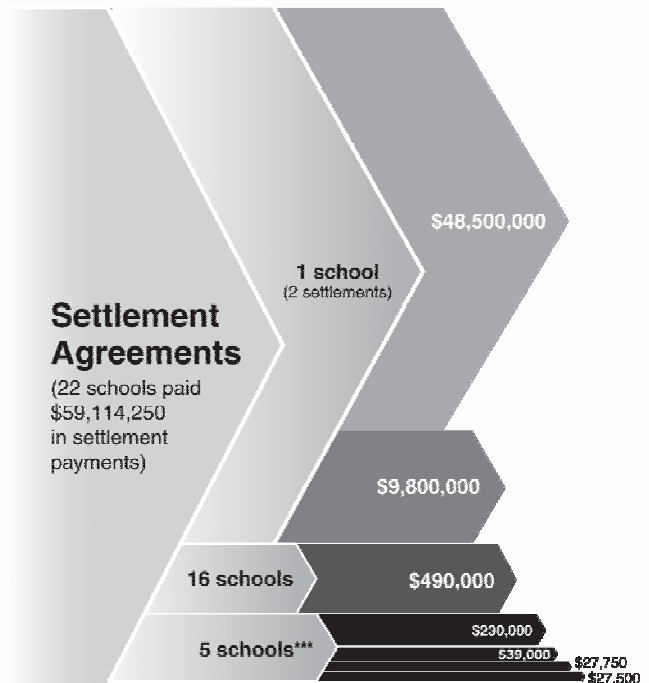
**Of the 6 schools, 3 schools closed before the violation was substantiated, 1 school's compensation program became acceptable with the introduction of the safe harbor regulations, and 2 schools were terminated from federal student aid programs before the violation was substantiated. Neither of these terminations were related to incentive compensation violations.



Enforcement: Resolution of Cases

Education Reached Settlement Agreements with 22 Additional Schools to Resolve Incentive Compensation Cases

- Settlement agreements included over \$59 million in payments to Education.
- 16 of the 22 settlement agreements were related to the Institute for Professional Development’s recruiting contract with schools.*
 - The 16 settlement payments ranged from \$5,000 to \$115,000.
- Two of the settlements were with the University of Phoenix.*
 - The first settlement resolved findings in a program review and included a settlement payment of \$9.8 million.
 - The second settlement resolved a qui tam lawsuit under the False Claims Act and included a settlement payment of \$48.5 million to Education.**



*University of Phoenix and the Institute for Professional Development are both owned by the Apollo Group.
 **Both Phoenix settlements relate to some of the same violations.
 ***Education and a nonprofit school settled an incentive compensation case based on findings in a program review without a settlement payment.



Enforcement: Resolution of Cases

Education Has Not used its Authority to Limit, Suspend, or Terminate any School's Federal Student Aid Access Because of Incentive Compensation Violations

In addition to imposing fines, liabilities, or reaching settlements with a school, Education has the authority to sanction a school for violating federal student aid statutory and regulatory requirements by limiting, suspending, or terminating that school from participating in federal student aid programs.*

- According to Education officials, other enforcement actions that the agency can take, such as changing a school's participation status to "provisional," are more effective than limiting or suspending a school's participation in the federal student aid program.**
 - To date, Education has not limited or suspended a school or used these other enforcement actions in incentive compensation cases.
- Education officials also noted that they have not terminated a school for incentive compensation issues. They were primarily concerned that schools would challenge terminations and Education would need to invest resources in litigating cases without necessarily prevailing in those terminations. The officials further said that they have never attempted to terminate a school for incentive compensation issues.

*These administrative actions are provided for in statute and regulation for Education. See 20 U.S.C. § 1094(c)(1) and 34 C.F.R. § 668 Subpart G. Schools with limitations may have restrictions on the number of students they can enroll who receive federal student aid funding or on the amount of federal student aid funding the schools can receive. Generally, schools can be suspended from participating in federal student aid programs for up to 60 days.

**When a school's status is provisional, Education closely monitors the school and can quickly revoke the school's eligibility to participate in the federal student aid program if needed.



Enforcement: Policy Changes

Education Changed its Enforcement Policy in 2002, which Increased the Burden to Prove a Violation and Lessened Financial Penalties

In October 2002, Education issued an internal policy memo—called the Hansen memo—which changed the Department’s enforcement approach for incentive compensation violations from identifying liabilities to assessing fines.

- Fines are often significantly smaller dollar amounts than liabilities, which require a school to pay back federal student aid funds related to a violation.
- In addition, when assessing a fine, the burden of proving a violation is on Education. In contrast, when Education identifies a liability, the burden is on the school to prove its compliance.*

*Regulatory requirements place the burden of proof on Education when assessing a fine because it is a penalty for misconduct. In contrast, the burden of proof is on the school when Education identifies liabilities because the school must prove that the federal student aid funds it received were properly used. See 34 C.F.R. § 668.88(c)(2) and § 668.116(d).



Enforcement: Policy Changes

Education Changed its Enforcement Policy in 2002, which Increased the Burden to Prove a Violation and Lessened Financial Penalties (cont'd)

- Education issued the safe harbor regulations almost concurrently with the Hansen memo. The safe harbor regulations identified 12 compensation arrangements that did not fall within the scope of the ban.
- According to Education officials, the safe harbor regulations made it more difficult to prove a school paid incentive compensation.*
 - Education officials said the first safe harbor—which allows for two annual adjustments to compensation, as long as the adjustments are not solely based on enrollments—is particularly problematic. Specifically, officials reported challenges in proving that changes to employee pay were solely based on enrollments, as required to substantiate a violation.
 - Education officials told us the term “solely” is unclear, making it difficult to successfully pursue an incentive compensation case.
 - Furthermore, Education reported expending significant resources in time and effort evaluating the legitimacy of compensation plans.

* As noted earlier, Education proposed new regulations in June 2010, which would eliminate the safe harbors.



Enforcement: Limitations in Guidance

Education's Guidance Establishes Caps on Total Penalty Amounts Although Regulations Do Not Have Such Caps

- Education officials shared with us internal guidance that the agency has used to determine fines and settlement payments for incentive compensation cases.*
- However, this guidance has a cap or limit on the total amount of financial penalties, whereas Education's regulations do not. For example:
 - The internal guidance sets a maximum financial penalty of \$27,500 when a school violates the incentive compensation ban.
 - In contrast, Education officials note that regulations do not impose a cap on the total fine amount. For example, schools can be fined \$27,500 each time a recruiter is improperly paid a bonus.** Consequently, a school's total fine can be much higher than \$27,500.
- Education officials have stated that the agency does not always use this guidance when determining fines and settlement payments. For example:
 - Education has imposed total fine/settlement payments of up to \$9,800,000 and the median amount has been \$30,000.***

*The fine guidance is an internal Education document that describes the suggested fine amounts for different types of federal student aid violations. Although settlements are generally negotiated between two parties, Education officials told us the fine guidance is used to determine settlement payments.

**See 34 C.F.R. § 668.84(a)(1) and § 668.92.

***The \$48.5 million the University of Phoenix paid settled a qui tam suit under the False Claims Act and was negotiated with additional parties including the U.S. Department of Justice and the U.S. Attorney.



Enforcement: Inconsistent Implementation

Education’s Varying Enforcement Approaches Could Lead to Inconsistent Treatment of Schools

- Education treated schools differently in determining whether or not to impose fines in addition to corrective action for incentive compensation violations.
- Some schools had fines imposed for incentive compensation violations, while others only had corrective action.
- According to Education officials and procedures, fine action is determined on a case by case basis given the unique circumstances of that case.
- However, the reasoning behind Education’s decisions to impose or not impose fines is not always clear. For example:
 - Education withdrew an initiated fine of over \$2 million for High-Tech Holdings (the parent company of High-Tech Institute and The Bryman School of Arizona) for violating the incentive compensation ban and resolved the case through corrective action alone.*
 - Case documentation that we received did not explain the reason for the fine withdrawal.**

*The telemarketing department of High-Tech Holdings provided bonuses totaling \$359,405 to recruiters for enrolling 4,750 students. High Tech Institute is currently named Anthem College.

**While an Education official told us additional information related to this decision may be available, Education was not able to provide supporting documentation to us regarding the reason for the fine withdrawal.



Enforcement: Inconsistent Implementation

Education's Varying Enforcement Approaches Could Lead to Inconsistent Treatment of Schools (cont'd)

- Education has used different definitions of an incident of incentive compensation in determining fine and settlement payments.
 - Education has determined an incident of incentive compensation to be either one student improperly recruited, one recruiter who received an improper payment, or one incentive payment made.
- According to Education officials, professional judgment based on the information available and unique characteristics of each case was used to define an incident of incentive compensation.
 - However, Education does not have guidance on how an incident of incentive compensation should be defined. Furthermore, case documentation did not provide an explanation for how Education chose the definition of an incident of incentive compensation.
 - Lack of guidance or documentation supporting how incident definitions are selected could lead to inconsistencies in how Education resolves incentive compensation cases and determines fines and settlement payments.



Enforcement: Inconsistent Implementation

Education’s Varying Enforcement Approaches Could Lead to Inconsistent Treatment of Schools (cont’d)

Changing the definition of an incident could influence the total fine or settlement payment. For example, based on information provided in case documentation, if an alternative definition of an incident of incentive compensation were used, the total fine amount could be substantially different, as illustrated in Table 1.

Table 1: Total Fines or Settlement Payments Vary Depending on Definition of Incentive Compensation Incident

Schools	Actual Fine/Settlement Payment <small>(based on definition of an incident used to determine fine or settlement payment)</small>	Alternative Fine/Settlement Payment <small>(based on alternative definitions of an incident that could be used to determine a fine or settlement payment)</small>
Concordia College	\$10,000 (\$294 for each of the 34 incentive payments made)	\$1,176 (\$294 for each of the 4 recruiters receiving improper payments)
University of LaVerne	\$27,500 (\$6,875 for each of the 4 recruiters receiving improper payments)	\$2,942,500 (\$6,875 for each of the 428 students improperly recruited)

1. The alternative fine/settlement payment amounts were calculated using information provided by Education about incentive compensation issues at these schools.
2. This table assumes the payment per incident would remain the same with the alternative definition of an incident of incentive compensation.
3. According to Education officials, the characteristics of an incentive compensation case may impact how the fine or settlement payment is calculated. Education could determine the total fine or settlement payment first and calculate the payment amount per incident afterwards. Alternatively, Education could determine the payment per incident first and then calculate the total fine or settlement payment amount based on the number of incidents of incentive compensation.

Source: GAO analysis of Education documents.



Enforcement: Inconsistent Implementation

Education's Varying Enforcement Approaches Could Lead to Inconsistent Treatment of Schools (cont'd)

- According to Education officials, the Department identifies and uses aggravating and mitigating factors to determine a school's fine or settlement payment.
 - A mitigating factor, such as a school self-reporting incentive compensation payments, would reduce the financial penalty.
 - An aggravating factor, such as a school misleading Education about having ended an incentive compensation practice, would increase the financial penalty.
 - However, we found that mitigating factors did not always lead to a lower payment for each incident of incentive compensation and aggravating factors did not always lead to a higher payment for each incident of incentive compensation (See table 2 on slide 34 for more details).
-



Enforcement: Inconsistent Implementation

Education’s Varying Enforcement Approaches Could Lead to Inconsistent Treatment of Schools (cont’d)

Education determined that the University of Phoenix case had an *aggravating factor* and the University of LaVerne case had a *mitigating factor*. Despite these determinations, Education reached a settlement with the University of LaVerne that included a payment per incident more than twice the amount the University of Phoenix paid.

Table 2: Comparison of Two Settlements with Aggravating and Mitigating Factors

	University of Phoenix	University of LaVerne
Incentive Compensation Case	A program review found the school’s compensation of recruiters did not comply with the ban.	An OIG audit found that the school had a bonus pool based on revenue gained from enrollments exceeding the base enrollment quota.
Aggravating or Mitigating Factors	Education determined that the school was fully aware of the incentive compensation ban; yet, it devised an illegal compensation practice and maintained two sets of books in the event of being audited.	Education determined that the school had no intent to deceive the Department.
Incentive Compensation Paid	More than \$29 million	\$70,408
Settlement Payment *	\$3,302 per incident , \$9.8 million total (incident = the number of illegal payments made)	\$6,875 per incident , \$27,500 total (incident = the number of recruiters paid)

Source: GAO analysis of settlement information provided by Education.

*We recognize that a variety of factors are used to determine the payment amount in settlement negotiations and that these factors may have contributed to different per incident payment amounts for these schools.



Conclusions

- The ban on incentive compensation was put into place to help protect students and federal student aid funds.
 - Recent focus on aggressive and inappropriate recruiting practices at some schools has renewed concerns about the adequacy of federal oversight of recruiter compensation practices.
 - Students and the federal investment in their education are put at risk without strong monitoring processes to detect potential incentive compensation violations at schools.
 - Furthermore, limited information on Education's total effort to monitor school compliance with the incentive compensation ban may hinder its ability to effectively and efficiently target its monitoring resources.
 - In addition, Education's disparate treatment of schools raises questions about whether its enforcement of the ban is fair and appropriate when penalizing schools and effective as a deterrent to future violations.
-



Conclusions

- Strengthening Education's monitoring and enforcement of the incentive compensation ban can:
 - help identify those schools that are inappropriately compensating recruiters and level the playing field for schools that comply with the ban,
 - help protect students who need accurate information during the recruitment process, and
 - safeguard federal student aid funds from fraud and abuse.



Recommendations for Executive Action

In order to help ensure that potential violations of the incentive compensation ban are identified, the Secretary of Education should coordinate with Education's OIG to strengthen the suggested procedures provided to auditors for auditing and reviewing school compliance with the ban.

- For example, Education could provide suggested step-by-step procedures and specific examples of how to test compliance with the incentive compensation ban.
 - This information could include minimum standards for evaluating compliance, examples of red flags that would trigger further review, and references to additional school records that may contain information related to recruiter compensation.



Recommendations for Executive Action

In order to help Education improve its monitoring of school compliance with the incentive compensation ban, the Secretary of Education should track the total number of program reviews it conducts specifically looking at incentive compensation issues.

- Education could do this by adding a component to its existing data system—as it has done in the past as monitoring needs changed—that will capture the reason for the initiated review.



Recommendations for Executive Action

In order to help ensure Education's enforcement of the incentive compensation ban is fair and consistent when determining fines and settlement payments, the Secretary of Education should:

- update the guidance used to set fines and settlement payments to establish appropriate penalties, and
- apply the guidance when determining fines and settlement payments for incentive compensation cases.

The guidance could establish an appropriate range for financial penalties associated with incentive compensation cases. In addition, it could lay out a process for weighing different factors that could affect the final payment amount in an incentive compensation case. Education staff could then use their professional judgment to weigh these factors and determine the exact fine or settlement amount within the overall range outlined in the guidance. This would help ensure a clear understanding of any differences in the fines and settlement payments associated with incentive compensation cases.

Appendix II: Department of Education Safe Harbor Regulations

The Safe Harbor regulations, found at 34 C.F.R. § 668.14(b)(22)(ii)(A) through (L) provide that the activities and arrangements schools may carry out without violating the incentive compensation ban include, but are not limited to, the following activities and arrangements:

- (1) the payment of fixed compensation, such as a fixed annual salary or a fixed hourly wage, as long as that compensation is not adjusted up or down more than twice during any 12-month period, and any adjustment is not based solely on the number of students recruited, admitted, enrolled, or awarded financial aid. For this purpose, an increase in fixed compensation resulting from a cost of living increase that is paid to all or substantially all full-time employees is not considered an adjustment;
- (2) compensation to recruiters based upon their recruitment of students who enroll only in programs that are not eligible for Title IV, HEA program funds;
- (3) compensation to recruiters who arrange contracts between the institution and an employer under which the employer's employees enroll in the institution, and the employer pays, directly or by reimbursement, 50 percent or more of the tuition and fees charged to its employees; provided that the compensation is not based upon the number of employees who enroll in the institution, or the revenue they generate, and the recruiters have no contact with the employees;
- (4) compensation paid as part of a profit-sharing or bonus plan, as long as those payments are substantially the same amount or the same percentage of salary or wages, and made to all or substantially all of the institution's full-time professional and administrative staff. Such payments can be limited to all, or substantially all of the full-time employees at one or more organizational level at the institution, except that an organizational level may not consist predominantly of recruiters, admissions staff, or financial aid staff;
- (5) compensation that is based upon students successfully completing their educational programs, or 1 academic year of their educational programs, whichever is shorter. For this purpose, successful completion of an academic year means that the student has earned at least 24 semester or trimester credit hours or 36 quarter credit hours, or has successfully completed at least 900 clock hours of instruction at the institution;

(6) compensation paid to employees who perform clerical “pre-enrollment” activities, such as answering telephone calls, referring inquiries, or distributing institutional materials;

(7) compensation to managerial or supervisory employees who do not directly manage or supervise employees who are directly involved in recruiting or admissions activities, or the awarding of Title IV, HEA program funds;

(8) the awarding of token gifts to the institution’s students or alumni, provided that the gifts are not in the form of money, no more than one gift is provided annually to an individual, and the cost of the gift is not more than \$100;

(9) profit distributions are proportionately based upon an individual’s ownership interest in the institution;

(10) compensation paid for Internet-based recruitment and admission activities that provide information about the institution to prospective students, refer prospective students to the institution, or permit prospective students to apply for admission online;

(11) payments to third parties, including tuition sharing arrangements, that deliver various services to the institution, provided that none of the services involve recruiting or admission activities, or the awarding of Title IV, HEA program funds; and

(12) payments to third parties, including tuition sharing arrangements, that deliver various services to the institution, even if one of the services involves recruiting or admission activities or the awarding of Title IV, HEA program funds, provided that the individuals performing the recruitment or admission activities, or the awarding of Title IV, HEA program funds, are not compensated in a manner that would be impermissible under paragraph (b)(22) of this section. [Section (b)(22) prohibits the payment of any commission, bonus, or other incentive payment based directly or indirectly upon success in securing enrollments or financial aid to any person or entity engaged in any student recruiting or admission activities or in making decisions regarding the awarding of Title IV, HEA program funds].

Appendix III: Objectives, Scope, and Methodology

Objectives

This appendix discusses in detail our methodology for addressing the following research questions: (1) How does Education monitor schools for potential violations of the incentive compensation ban? and (2) To what extent does Education use its authority to enforce compliance with the incentive compensation ban?

To address these research questions we reviewed Education's policies, procedures, and guidance; examined incentive compensation case documentation from 1998 through 2009; interviewed officials from Education, Education's Office of Inspector General (OIG), independent auditors who conduct annual school audits, and associations representing various school sectors and students; reviewed prior GAO and OIG higher education reports, relevant laws and regulations, and standards for internal controls in the federal government; and analyzed Education's enforcement data.

We conducted our work from December 2009 through October 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and recommendations based on our audit objectives.

Analysis of Education Policies, Procedures, and Guides

To determine how Education monitors and enforces school compliance with the incentive compensation ban, we reviewed Education's policies and procedures for oversight of the incentive compensation ban. In addition, we reviewed Education's OIG audit guide provided to independent auditors to help monitor schools for compliance with federal student aid eligibility requirements, including the incentive compensation ban. We also reviewed the Office of Management and Budget A-133 Circular for single audits, which provides information for audits of public and nonprofit schools.

Department of Education, Auditor, and Association Interviews

To examine Education's monitoring and enforcement of school compliance with the incentive compensation ban we interviewed officials from Education, independent auditors who conduct annual school audits, and personnel from associations representing various school sectors and students. At Education, we interviewed officials at the office of Federal Student Aid, field offices, the General Counsel's Office, the Office of Inspector General, and the office of Postsecondary Education. We also

interviewed auditors from the following audit firms: Barry Glasser and Company; Deloitte & Touche; Deemer Dana & Froehle LLP; Kessler Orlean Silver & Company PC; Johnston & Hayden, LLC; Knutte & Associates; KPMG; David A. Levy, CPA PC; Moss Adams; Parente Beard; Plante & Moran; PriceWaterHouse Coopers; Rosenberg Jurash & Associates; Salmon Sims Thomas & Associates; and West & Company. The audit firms selected represent those conducting both low- and high-volume audits, as well as audits at private for-profit, public, and private nonprofit schools. In addition, we spoke with representatives from the American Institute of Certified Public Accountants, the national association representing accountants.

We also interviewed officials from a broad range of higher education associations and interest groups including the National Association of Independent Colleges and Universities, the American Association of Community Colleges, the Career College Association, the National Association of College Admissions Counselors, and the American Association of Collegiate Registrars and Admissions Officers.

Analysis of Education Data and Case Documentation

To determine the extent to which Education has used its authority to enforce compliance with the incentive compensation ban, we obtained information from Education's PEPs database on incentive compensation findings from January 1998 through December 2009.¹ This database includes information on qui tam suits filed by citizens under the False Claims Act that involved the Department of Education. We supplemented this information with an analysis of relevant incentive compensation case documentation, relevant laws and regulations, and enforcement actions taken against schools. We assessed the reliability of this data by: (1) examining the data; (2) comparing the data to available case documentation such as final determination letters or settlement agreements; and (3) interviewing Education officials. We determined the data reviewed to be sufficiently reliable for the purposes of this report.

As part of our analysis of Education's monitoring efforts, we also obtained and analyzed Education's OIG quality reviews of select audits from fiscal years 2007 through 2009. The reviewed audits are not randomly selected and, therefore, the results cannot be generalized to the entire population

¹Congress mandated that our review of Education's enforcement activities focus on Education's actions since 1998.

of audits. Nevertheless, the audits do shed light on deficiencies in the annual audits.

Appendix IV: Comments from the Department of Education



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CHIEF OPERATING OFFICER

September 24, 2010

Ms. Katherine M. Iritani
Acting Director
Education, Workforce, and
Income Security Issues
United States Government Accountability Office
Washington, DC 20548

Dear Ms. Iritani:

Thank you for providing the U.S. Department of Education (the Department) with a draft copy of the U.S. Government Accountability Office's (GAO's) report entitled, "Higher Education: Stronger Federal Oversight Needed to Enforce Ban on Incentive Payments to School Recruiters" (GAO-11-10).

The Higher Education Opportunity Act (HEOA) required that GAO conduct a study of the Department's enforcement of the incentive compensation provisions at § 487(a)(20) of the Higher Education Act (HEA). GAO must include in the report an analysis of the nature, extent, and effectiveness of the Department's enforcement activities; the number of institutions for which the Department initiated investigations since 1998; where violations were substantiated, the names of the institutions, the nature of the violations, and the penalty, if any, imposed; an analysis of the impact of the "safe harbor" regulations at 34 C.F.R. § 668.14(b)(22)(ii)(A) through (L) on the number and nature of cases examined for violations by the Department; information on the extent to which the Department has considered State efforts to examine unethical or unlawful student recruitment or admissions practices, including practices that violate the statutory provisions; and information on the extent to which the Department reviews publicly available documents, such as filings to the Securities and Exchange Commission, to monitor compliance. As a result of its study, GAO made three recommendations to the Department. Below are the Department's responses to each recommendation, as well as comments regarding other statements within the report that are otherwise related to each recommendation.

Recommendation 1: *In order to help ensure that potential violations of the incentive compensation ban are identified, the Secretary of Education should coordinate with Education's OIG to strengthen the suggested procedures provided to auditors for auditing*

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references to additional school records that may contain information related to recruiter compensation.

Response: We agree with this recommendation. Federal Student Aid will provide Education's Office of Inspector General (OIG) with suggestions to strengthen the procedures provided to auditors for auditing and reviewing school compliance with the incentive compensation ban.

Recommendation 2: *In order to help Education improve its monitoring of school compliance with the incentive compensation ban, the Secretary of Education should track the total number of program reviews it conducts specifically looking at incentive compensation issues. Education could do this by adding a component to its existing data system—as it has done in the past as monitoring needs change—that will capture the reason for the initiated review.*

Response: We agree with this recommendation. Program Compliance of Federal Student Aid requested that a code corresponding to incentive compensation be added in its data system to track the type/scope of program review conducted. This should enable the Department to more effectively track program reviews that were initiated as a result of incentive compensation concerns.

Recommendation 3: *In order to help ensure that Education's enforcement of the incentive compensation ban is fair and consistent when determining fines and settlement payments, the Secretary of Education should: update the guidance used to set fines and settlement payments to establish appropriate penalties, and apply the guidance when determining fines and settlement payments for incentive compensation cases.*

Response: We agree with this recommendation. The Department issued a notice of proposed rulemaking that addresses the issue of incentive compensation, and it anticipates publishing a final rule in the coming weeks. The Department agrees that after the final rule is published, the Department should update its compliance guidance with respect to incentive compensation. Additional background is provided in Appendix A.

We greatly appreciate your examination of this important issue.

Sincerely,

Thad Anderson, Chief Risk Officer

For:
William J. Taggart
Chief Operating Officer

Enclosure

APPENDIX A

As the Department noted to GAO during data collection for this engagement, it implemented standard procedures in 2006 regarding program reviews and audits in an effort to, among other things, ensure that the possibility of a fine is consistently considered going forward. In addition, the Department explained that, in some cases when it considered whether to assess a fine, it determined that no action was appropriate because the violations were *de minimus*.

The Department also noted that it uses the information available about a school's incentive compensation practices, coupled with professional judgment, to determine a fine/settlement amount. Accordingly, the Department has defined an "incident of incentive compensation" as one student improperly recruited, one recruiter who received an improper payment, or one incentive payment made, consistent with the specific/unique facts of each case. The Charts at pages 32 and 34 of the draft report illustrate why the Department uses professional judgment to define an "incident" for purposes of determining an appropriate fine amount.

The Department has faced many challenges in its enforcement efforts. Among those challenges is the language in the first safe harbor, spawned by the legislative history, which states that compensation cannot *solely* be a function of the number of students recruited, admitted, enrolled, or awarded financial aid. 34 C.F.R. § 668.14(b)(22)(ii)(A). Challengers contend that this language means that any enforcement action the Department takes against a school for payments to a recruiter of students that are based in part—even 99%—on the number of students a recruiter enrolls is contrary to the first safe harbor. Please note that pursuant to negotiated rulemaking, the Department has proposed changes to the regulations implementing § 487(a)(20) of the HEA that would eliminate all of the safe harbors. The publication of the final regulations, expected to occur by November 1, 2010, affords the Department an excellent opportunity to revise its guidance in this area.

Appendix V: GAO Contact and Staff Acknowledgments

GAO Contact

Katherine M. Iritani at (206) 287-4820 or iritanik@gao.gov

Staff Acknowledgments

In addition to the contact named above, the following staff members made important contributions to this report: Melissa Emrey-Arras, Assistant Director; Claudine Pauselli, Analyst-in-Charge; Colleen Moffatt; and Ann Rivlin. Also, Jean McSween provided guidance on the study's data analysis; Jessica Botsford and Sheila McCoy provided legal advice; James Bennett and Mimi Nguyen assisted with report graphics; Susan Aschoff provided writing assistance; and Andrew Nelson and Amy Anderson verified our findings.

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