

ED's New Audit Guide Mandates Greater Scrutiny of Compensation Practices under the "Incentive Compensation" Rule

July 31, 2017

As discussed in [last week's post](#), Title IV compliance audits for entities' fiscal years ending June 30, 2017 and later must be completed using the revised Audit Guide recently issued by the US Department of Education's Office of Inspector General (OIG). The new Audit Guide establishes the requirements for compliance audits of for-profit schools and third-party servicers that administer any aspect of the Title IV programs on behalf of any postsecondary institutions.

One very significant change in the Audit Guide requirements that is already getting a great deal of attention is the expansion of the review required by auditors to assure compliance with the incentive compensation rule, which prohibits any employee or entity involved in recruiting, admissions or financial aid activities from receiving compensation based directly or indirectly on the number of students they enroll or the amount of financial aid they secure. What was a single paragraph in the predecessor 2000 Audit Guide, instructing auditors to check payroll and disbursement records, now spans 2 ½ full pages in the new Audit Guide, including interpretative guidance from the OIG, which has been critical of ED's enforcement efforts with regard to this rule. For example, the Audit Guide now suggests auditors look for potential indicators of incentive compensation violations such as rapid enrollment growth, ownership changes, high turnover of recruiting staff, employee tracking based on enrollment success and compensation plans that show adjustments throughout the year.

The following are some of the most notable changes in the Audit Guide requirements concerning compliance with the incentive compensation regulations:

1. Application to third-party contractors

Auditors are now required to review in detail the compliance of any entities that a school has hired for recruiting, admissions, enrollment, or the awarding of Title IV funds. Auditors are instructed to pay particular attention to tuition-sharing agreements with outside recruiting entities, which are only permitted in limited circumstances where the contractor is unaffiliated with any educational institution and provides a "bundle of services" to the school. The OIG, which has in the past been critical of the "bundled services" approach under the incentive compensation rule, goes on to suggest that *"Auditors should be cautious of circumstances where a claimed 'bundle of services' may be illusory or inconsequential, and should assure themselves that the entity is not affiliated with the school it serves or any other school."*

The new Audit Guide also provides that if the auditor cannot obtain access to the contractor's records and employees to conduct the required audit, the auditor must issue a scope limitation in the audit report. A scope limitation could trigger a closer review of a school's practices as well as a separate review by ED and possibly other penalties.

We expect these new requirements may necessitate further negotiation between schools and vendors as to audit rights, and awkward discussions between auditors and schools as to whether a particular agreement is even subject to the incentive compensation rule.

2. Expanded document and record review

Previously, the Audit Guide recommended that auditors look at payroll and other disbursement records. Now auditors are required to review a lengthy list of records in addition to payment records including compensation plans, contracts, performance evaluations, performance agreements, wage or salary adjustments, personnel files, invoices, policies for compensation adjustment, profit sharing payments and internal controls for compensation adjustments.

Auditors are also now required to review a sample of the salary adjustments made for employees of the institution and employees of any outside entity that the institution uses for recruiting students or awarding Title IV funds, to determine if each adjustment was permissible under the incentive compensation restrictions.

These more extensive record reviews are expected to make audits significantly more difficult (and more expensive) to complete.

3. Rewards other than monetary compensation

The new Audit Guide includes a section detailing that “anything of value” given to employees should be reviewed to determine if it was awarded based on securing enrollments or awarding Title IV funds. The Audit Guide gives as examples rewards such as trips, concert tickets, and electronics. The precise meaning of the “anything of value” provision of the incentive compensation regulations is one that many institutions have been unclear about, but we do not think that the audit firms have any clearer guidance from ED on this point.

Due to the greater breadth and depth of the required audit procedures involving compliance with the incentive compensation rules, as well as other Audit Guide requirements, schools should allow more time to prepare for and undergo their annual compliance audits. Given the very high profile nature of the incentive compensation restrictions in multiple lawsuits, investigations and program reviews over the years, we expect that annual compliance audits will be a new front in which these issues receive greatly increased attention. Schools and third-party servicers will be well served to prepare thoroughly for the audit of this area, and to respond carefully to all of the auditor’s inquiries, in an effort to minimize any adverse findings.

We will be issuing additional blog posts about other aspects of the new Audit Guide in the coming weeks. Please contact Cooley if you would like to discuss any issues related to your annual compliance audits.

Blain Butner is a senior member and former co-leader of Cooley’s education practice group, and has been providing advice and counsel to educational institutions for 35 years.

This content is provided for general informational purposes only, and your access or use of the content does not create an attorney-client relationship between you or your organization and Cooley LLP, Cooley (UK) LLP, or any other affiliated practice or entity (collectively referred to as “Cooley”). By accessing this content, you agree that the information provided does not constitute legal or other professional advice. This content is not a substitute for obtaining legal advice from a qualified attorney licensed in your jurisdiction, and you should not act or refrain from acting based on this content. This content may be changed without notice. It is not guaranteed to be complete, correct or up to date, and it may not reflect the most current legal developments. Prior results do not guarantee a similar outcome. Do not send any confidential information to Cooley, as we do not have any duty to keep any information you provide to us confidential. This content may have been generated with the assistance of artificial intelligence (AI) in accordance with our [AI Principles](#), may be considered Attorney Advertising and is subject to our [legal notices](#). Copyright © 2026