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Information Item

California Student Aid Commission

Report on Bureau of State Audits January 2010 report on
"Recommendations Not Fully Implemented After One Year:
The Omnibus Audit Accountability Act of 2006"

In April 2006, the Bureau of State Audits issued Audit Report 2005-120 entitled "California Student Aid Commission: Changes in the Federal Family Education Loan Program, Questionable Decisions, and Inadequate Oversight Raise Doubts About the Financial Stability of the Student Loan Program" (Report 2005-120). The report contained eight recommendations that the Commission implement to improve its oversight and the financial viability of EdFund.

Following issuance of the report, the Commission acted to implement many of the changes as recommended. However, the Commission has been unable to fully implement three of the recommendations relating to the Voluntary Flexible Agreement / EdFund business diversification, improved oversight of EdFund, and independent verification of reports provided by EdFund. Implementing the remaining findings has been problematic primarily because of the proposed elimination of the Federal Family Education Loan Program and the enactment of Senate Bill 89.

The Bureau of State Audits (BSA) is required to issue a report of audit findings that are not fully implemented within one year as a result of the Omnibus Audit Accountability Act of 2006 (Art. 4 (commencing with section 8548.7) Ch. 6.5, Div. 1, Title 2 Gov. Code). In its most recent report, BSA has noted that the Commission has not fully implemented three findings from Report 2005-120.

Commission staff was given the opportunity to provide a response to BSA explaining the Commission's inability to fully implement the recommendations from Report 2005-120. BSA includes the staff response when it issues its report. A copy of the BSA report, including the staff response, is included as Tab 5.a.

Responsible Person(s): Keri Tippins
General Counsel

CALIFORNIA STATE AUDITOR

Bureau of State Audits

Recommendations Not Fully Implemented After One Year

The Omnibus Audit Accountability Act of 2006

SPECIAL REPORT

January 2010 Report 2009-041

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January 14, 2010 2009-041

Dear Governor and Legislative Leaders:

Consistent with the Omnibus Audit Accountability Act of 2006 (California Government Code, sections 8548.7 and 8548.9), the Bureau of State Audits (bureau) presents its special report to the Joint Legislative Audit Committee, Joint Legislative Budget Committee, and Department of Finance. This report lists 131 recommendations, made to 29 state agencies in audit reports issued from January 2005 through October 2008, that had been outstanding for at least one year and not fully implemented. Ninety of the 131 recommendations remain not fully implemented. In addition to identifying which recommendations have and have not been fully implemented, this report contains written responses from each state agency explaining the status of each recommendation. For recommendations that have not been fully implemented, this report also provides agency responses regarding when these recommendations will be fully implemented.

Our audit efforts bring the greatest returns when agencies act upon our findings and recommendations. For example, in April 2008 the bureau reported that its comparison of Department of Social Services' (Social Services) and Department of Justice's (Justice) databases found 49 instances in which the registered addresses in Justice's database for sex offenders were the same as the official addresses of facilities licensed by Social Services to serve children, such as family day care homes. In response to the bureau's recommendation, Social Services and Justice negotiated an interagency agreement that allows data sharing and investigations to take place.

If you would like more information or assistance regarding any of the recommendations or background provided in this report, please contact Margarita Fernández, Chief of Public Affairs, at 445-0255.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
State Auditor

HIGHER EDUCATION

CALIFORNIA STUDENT AID COMMISSION

(Report Number 2005-120, April 2006)

Changes in the Federal Family Education Loan Program, Questionable Decisions, and Inadequate Oversight Raise Doubts About the Financial Stability of the Student Loan Program

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) review California Student Aid Commission's (Student Aid) governance and oversight of its auxiliary organization, known as EDFUND, including EDFUND's financial management and business practices. The audit committee was interested in ensuring the proper use of state assets in maximizing support for financial aid purposes.

The following table summarizes the auditee's progress in implementing the eight recommendations the bureau made in the above referenced report. As shown in the table, as of its one-year response, the auditee had not fully implemented six of those recommendations. Based on the auditee's most recent response, two recommendations remain outstanding.

TOTAL RECOMMENDATIONS	NOT IMPLEMENTED AFTER ONE YEAR	NOT IMPLEMENTED AS OF 2008-041 RESPONSE	NOT IMPLEMENTED AS OF MOST RECENT RESPONSE
8	6	2	2

In September 2007 the bureau issued a follow-up report titled *California Student Aid Commission Follow-Up: Although Changes to the Commission's Business Model Have Produced Positive Results, Proposed Federal Changes Could Affect Federal Family Education Loan Program Revenues* (Report No. 2007-505). In this report the bureau performed additional audit work pertaining to the status of recommendations it issued in 2006.

Below are the recommendations that we determined were not fully implemented, followed by the auditee's most recent response for each.

Recommendation #1:

a. Student Aid should ensure that critical tasks, including the renegotiation of its Voluntary Flexible Agreement with the Department of Education and the development of a diversification plan are completed.

b. Student Aid should ensure that the roles and responsibilities it delineates for itself and EDFUND do not inappropriately cede its statutory responsibilities to EDFUND.

Bureau's assessment of status: **Not fully implemented**

Auditee's Response to Recommendation (a):

With respect to the Voluntary Flexible Agreement (VFA), this Recommendation has been implemented and the status of any possible future VFA with the U.S. Department of Education (USDE) is uncertain because USED has suspended VFA negotiations as a result of President Obama's proposal to eliminate the Federal Family Education Loan (FFEL) Program as of July 1, 2010. At the time the Bureau of State Audits issued Report Number 2005-120 in Apri 2006, the VFA that went into effect in 2001 had not been renegotiated. As has been noted previously, the USDE did not renegotiate VFAs with any of the guaranty agencies as a result of the College Cost Reduction and Access Act of 2007 (P.L. 110-84) which significantly reduced standard payments from the USDE to guaranty agencies. After reviewing the impact of these changes on the VFA, the USDE determined the VFA was no longer cost-neutral as required under 5428A of the Higher Education Act of 1965, as amended (HEA) and terminated the agreements effective January 1, 2008. The Commission did receive revenue under the VFA through the date of termination.

In March 2008, the Commission/EdFund submitted a new proposal for a VFA. This proposal was found to be cost-neutral and in July 2008, the Department of Education provided to the Commission a draft of the terms for the new VFA. Certain provisions of the draft were unacceptable, as presented to the Commission, and the Chair of the Commission asked the Commission's General Counsel to work with legal staff from USDE to develop mutually agreeable language. Before the language of the VFA could be finalized, certain other issues arose which prompted the USDE to delay the execution of the final VFA. It is unlikely the USDE will be moving forward to complete the negotiation of a new VFA with the FFELP guarantee agencies until the future of the FFEL Program is resolved. President Obama has proposed eliminating the FFEL Program and utilizing the savings from that program to, among other things, increase direct spending for the Federal Pell Grant Program. The legislation that would enact these changes, H.R. 3221, the Student Aid and Fiscal Responsibility Act of 2009, is currently pending.

With respect to the development of a business diversification plan, this Recommendation has not been implemented and will not be implemented within the next 90 days. As noted in the previous three responses to the status of the audit findings, the funds in the Student Loan Operating Fund (SLOF) are insufficient to support any significant proposals for diversification. With the proposed elimination of the FFEL Program, future income to the SLOF may be reduced significantly, and any diversification activity that was considered at the time of the issuance of the April 2006 report, would need to be revisited under new federal student aid system. The future role, if any, that FFEL Program guaranty agencies may play in the future remains undetermined.

In addition, in August 2007, Senate Bill 89 (Chapter 182, Statutes of 2007) ("SB 89"), was enacted to sell the State's student loan guarantee program assets. SB 89 granted the Department of Finance authority to approve Commission actions and to take necessary action to preserve the value of state student loan guarantee assets until the consummation of their sale or any other transaction, to maximize the value of the FFEL Program to the State. SB 89 not only authorized the Department of Finance, in consultation with the State Treasurer, to sell state student loan guarantee program assets, or to enter into an alternative arrangement, but also granted additional authority to the Department. Specifically, SB 89 provided:

> The Director of Finance is authorized to take all actions that he or she deems to be necessary or convenient to accomplish any of the following:
>
> (1) To preserve the state student loan guarantee program assets, pending consummation of their sale or the consummation of any other transaction, to maximize the value of the state student loan guarantee program to the state. (See Education Code §69521.5(a)(1).)

Further:

SB 89 effectively made Department of Finance (DOF) responsible for the State's loan program. Until the consummation of the sale or other transaction to maximize the value of the state student loan guarantee program to the state, all actions, approvals, and directions of the State Aid Commission affecting the state student loan guarantee program shall be effective only upon the approval of the Director of Finance. (See Education Code §69521.5(c)(3).)

In addition to economic factors limiting business diversification, authority for such activity rests with the Director of Finance.

Estimated date of completion: Unknown

Auditee's Response to Recommendation (b):

While major advances have been made in implementing this recommendation; it has not been fully implemented. The Commission has developed Governance and Monitoring Policies and has continued to amend those policies as circumstances dictate. The Operating Agreement has also been amended as indicated in the April 23, 2007, response to the status of the audit findings.

Certain other action taken by the Commission to strengthen its statutory obligation to provide oversight to EdFund have been impacted by Senate Bill 89 (SB 89), which gave the Director of Finance the authority to sell the loan program assets. The Director of Finance has utilized his authority under SB 89 to overturn the following actions taken by the Commission at its September 4-5, 2008 meeting:

- The Commission acted to amend it own policy on EdFund Executive Compensation to protect the expenditure of state funds on severance, retention or other increased compensation packages for EdFund executives.

- The Commission acted to lessen the impact on the Student Loan Operating Fund of the Lease for EdFund's "Building B". EdFund originally leased two buildings with the intent that CSAC would occupy a portion of Building B. CSAC was later informed by the Department of Finance that it would not be occupying Building B, but would instead need to find alternate office space. No new tenant for Building B has been identified and the building remains vacant, with the attendant cost being charged to the Student Loan Operating Fund.

- The Commission acted to remove the EdFund Board of Directors and replace those individuals with the entire membership of the Commission. This action was taken so as to streamline governance efforts and resolve the communications breakdown between the Commission, the EdFund Board of Directors and the actions of the EdFund Executive Management Team. The need for this action was evidenced by several items on the September 2008 agenda that demonstrated EdFund had undertaken activity of significant importance to the loan program, and which obligated state funds, without informing either its Board or the Commission.

Additionally, the Director of Finance overturned the following actions taken by the Commission at its September 3, 2009 meeting:

- Due to the economic crisis and consistent with the Governor's direction and veto to reduce the expenditure of State funds, and more importantly to protect the safety net of financial aid to students, the California Student Aid Commission approved a three-month reduced budget for EdFund for the period of October 1, 2009 through December 31, 2009. It reduced the EdFund expenses without reducing revenue consistent with the Governor's direction. As a result, the state would have realized an annualized savings of $10 million that could be allocated to prevent disruption in the administration of Cal Grants and other financial aid programs to students. The $10 million annualized reduction in EdFund expenses included but was not limited to:
  - Savings equal to 3-day furloughs per employee consistent with State practice.
  - The elimination of incentive compensation as identified in the Commission action of July 1, 2009.
  - Reduction in non-critical expenditures in the areas of procurement and undefined contingency expenditures.

The Director of Finance insists that the Commission consult with the EdFund Board and receive concurrence with the Board and submit written notification signed by the Commission and the Board that agreement was reached on amendments to the Operating Agreement, changes to EdFund compensation policy, any potential furloughs of EdFund employees, and any reduction of EdFund expenses. This is directly contrary to the BSA recommendation that the Commission strengthen its statutory obligation to provide oversight to EdFund.

Under the current statutory scheme, the Commission will not be able to implement this recommendation within 90 days.

Estimated date of completion: Unknown

Recommendation #2:
Student Aid should also require staff to independently verify the accuracy of the reports submitted by EDFUND.

Bureau's assessment of status: **Not fully implemented**

Auditee's Response:

The recommendation has not been fully implemented, and cannot be implemented within 90 days because the California Student Aid Commission's division Federal Policy and Programs Division responsible for EdFund oversight no longer has the resources to independently verify the accuracy of the reports submitted by EdFund. As part of the 09/10 Budget, the Governor reduced the FPPD budget from $1,000,000 to $500,000 indicating, "I am reducing $500,000 from the Federal Policy and Program Division (FPPD) to align funding with the FPPD's responsibilities and to preserve resources. The current funding level exceeds what is necessary to support the staff of the FPPD. Furthermore, any savings that can be achieved in the Student Loan Operating Fund will result in the program being more valuable and thus result in additional General Fund revenue upon the sale, or other transaction, involving EdFund that is authorized by Chapter 182 of the Statutes of 2007." The current funding does not allow resources to fund approved staffing levels to perform the duties independently verifying the accuracy of the reports submitted by EdFund. Chapter 182, Statutes of 2007 (SB 89) enacted in August 2007 effectively made Department of Finance (DOF) responsible for the State's loan program. All of the actions, approvals, and directions of the Commission affecting the state student loan guarantee program shall be effective only upon the approval of the Director of Finance.

Estimated date of completion: Unknown