



October 21, 2008

Ms. Lorena Hernandez
Acting Chair
California Student Aid Commission
P.O. Box 419026
Rancho Cordova, CA 95741

Sister Sally Furay
Chair
EdFund Board of Directors
P.O. Box 419045
Rancho Cordova, CA 95741

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OSAO
EXECUTIVE OFFICE

Dear Ms. Hernandez and Sister Furay:

October 23, 2008 Commission Meeting—Office of State Audits and Evaluations Review of Allegations

I am hereby transmitting the results of the Office of State Audits and Evaluations' (OSAE) independent review of the allegations of inappropriate actions regarding EdFund provided by former Chair Hankwitz and, similarly, its review of allegations by EdFund about inappropriate actions by the California Student Aid Commission (Commission).

I am also requesting that you reserve adequate time for a presentation of the findings of this review by David Botelho, Chief of OSAE, and Kimberly Tarvin, Manager, for the review project at the Commission's October 23, 2008 scheduled meeting.

As you recall, I requested that the former chair allow time for an independent review of the allegations driving the September agenda prior to the Commission taking actions at the September 4 and 5 meeting that held the potential for devaluing the state's asset. While the Commission did not cooperate with that request, the review was implemented in order to determine which complaints could be substantiated in order to better inform me on what actions were in the best interests of both preserving the value of the state's asset consistent with my role pursuant to SB 89 and with the Commission's legal responsibilities to ensure effective oversight of the guaranty function.

Now that the review has been completed, it is clear to me that there are both substantiated and unsubstantiated allegations against both organizations. The severity of the substantiated actions are, of course, not all equal. In some cases, a substantiated allegation is simply factual but no wrong doing can be assigned (such as the fact that EdFund is obligated to pay for a vacant building because the Commission did not relocate in the building which was developed for them in a timely fashion). In other cases, there are mitigating circumstances such as unclear communications or policies in place between the two agencies that contributed to inappropriate actions (such as the discontinued default fee strategy which the Attorney General opined was inconsistent with federal rules).

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In total context, I find nothing in the review that would change my previous decision to not approve actions taken on September 4 and 5 for agenda items 9 and 10 regarding the removal of the EdFund Board, nor item 8 regarding the changes in compensation policy at this time. Moreover, I see nothing here that could not have been avoided if both agencies had practiced proper communication, worked together in a spirit of transparency and unified purpose, developed clear policies and procedures, respected Legislative intent, and recognized the unique reasons that the Legislature approved an auxiliary organization to operate the loan guaranty function in a competitive market place.

The review does, however, substantiate a need for better contract oversight and rescission of the marketing campaign as acted on in September under agenda items 4 and 5 of the meeting. It also substantiates a need for EdFund to refrain from expending funds for employee celebrations and coffee services, and a need for the Commission to follow the operating agreement more closely, implement an annual oversight plan, and develop more effective and timely dispute resolution processes regarding operating agreement issues.

If you have any questions, please call Jeannie Oropeza, Program Budget Manager, at 916-445-0328.

Sincerely,



MICHAEL C. GENEST
Director

Attachment

cc: Ms. Diana Fuentes-Michel, Executive Officer, California Student Aid Commission
Dr. Sam Kipp, President, EdFund

FINANCE

Date: October 10, 2008

To: Mike Genest, Director

From: David Botelho, Chief 
Office of State Audits and Evaluations

Subject: California Student Aid Commission and EdFund Concerns

Per your request, the Department of Finance, Office of State Audits and Evaluations (OSAE), has reviewed the following allegations and concerns brought to the attention of the Department of Finance (Finance) by the California Student Aid Commission (Commission) and EdFund in letters dated August 29, 2008, September 2, 2008, and September 15, 2008. Some of the concerns were reported to Finance during the review and were incorporated into the review. The results of OSAE's review are based upon interviews with the prior Commission Chair, EdFund Board Chair, Ed Fund executives, Commission executive management and staff, Finance management and staff, and reviews of documentation. The review was conducted between September 2, 2008 and October 9, 2008.

The results of our review are summarized below. For more detailed information, see Appendix A and B.

Issue		Results	Entity Reporting the Issue(s)
A1	Personal severance or retention bonuses for EdFund executive staff A. Pursuance of severance and bonus payments B. Bagley-Keene Open Meeting Act and Fair Political Practices Act violations C. Unauthorized continuance of salary survey D. Inappropriate Department of Finance position on severance and bonus payments without discussion with the Commission	Unsubstantiated Substantiated Substantiated Unsubstantiated	Commission Commission Commission Commission
A2	EdFund unapproved request for proposal for policy awareness and advocacy campaign issued by EdFund	Substantiated	Commission
A3	United States Department of Education concerns regarding EdFund management and the Voluntary Flexible Agreement	Undetermined	Commission and EdFund
A4	EdFund's unreimbursable federal default fee payments	Substantiated	Commission and EdFund
A5	EdFund inappropriately processed the lender of last resort \$5 million contract	Unsubstantiated	Commission and EdFund
A6	EdFund lease obligation of \$1.3 million for empty building A. Lease obligation for empty building B. Finance's approval delay caused excess moving	Substantiated	Commission

	costs	Unsubstantiated	Commission
Issue		Results	Entity Reporting the Issue(s)
A7	EdFund expenditures representing a waste of public funds A. Coffee services contract for employees of \$93,000 B. Barbeque relocation costs of \$1,500 C. EdFund rebranding contract for \$65,000 D. New building security system costing over \$400,000 E. Other expenditures	Substantiated Unsubstantiated Substantiated Unsubstantiated Substantiated	Commission Commission Commission Commission Commission
A8	Inappropriate prevention of outreach funding by EdFund and Finance	Unsubstantiated	Commission
A9	Same level of support services not provided to the Commission by EdFund	Unsubstantiated	Commission
A10	Finance has allowed EdFund management to circumvent Commission authority	Unsubstantiated	Commission
B1	Threats, retaliatory actions, and hostile work environment caused by the Commission A. Hostile work environment B. Transition to Direct Lending Program C. California-Only focus D. Bagley-Keene Open Meeting Act violations	Unsubstantiated Substantiated Unsubstantiated Unsubstantiated	EdFund EdFund EdFund EdFund
B2	Violation of state leasing protocols for office space	Unsubstantiated	EdFund
B3	Cash for College Workshops provided solely in Democratic regions for the Executive Director's own political favor	Unsubstantiated	EdFund
B4	Commission circumvention of state contracting protocol by daisy chaining contracts	Unsubstantiated	EdFund
B5	Commission churning of personnel vacancies	Undetermined	EdFund
B6	Commission diversion of salary savings to non-personnel expenses	Unsubstantiated	EdFund
B7	Commission Operating Agreement violations by the Commission A. July Joint Workshop not held B. Untimely reimbursement of expenses C. Inappropriate report development process D. Annual Oversight Plan not provided E. Refusal of Commission to hold joint resolution meeting	Substantiated Substantiated Undetermined Substantiated Substantiated	EdFund EdFund EdFund EdFund EdFund
B8	Commission release of confidential and proprietary documents to the press and/or public without prior consultation with EdFund	Unsubstantiated	EdFund
B9	Commission spending of unbudgeted and unauthorized state funds	Undetermined	Commission

OSAE appreciates the assistance and cooperation of the Commission, EdFund, and Finance Budget staff during this review. If you have any questions regarding this report, please contact Kimberly A. Tarvin, Manager at (916) 322-2985.

Enclosure

**California Student Aid Commission
Allegations and Concerns**

The Commission reported the following concerns in its August 29, 2008 letter to the Department of Finance (Finance).

1. Personal Severance or Retention Bonuses for EdFund Executive Staff

- A. *Pursuance of Severance and Bonus Payments:* EdFund management continues to pursue personal severance or retention bonus payments solely for the EdFund President and top executives under the guise of salary adjustments.
- B. *Bagley-Keene Open Meeting Act and Fair Political Practices Act Violations:* Two meetings were held that did not comply with the Bagley-Keene Open Meetings Act and/or the Fair Political Practices Act.
- C. *Unauthorized Continuance of Salary Survey:* The Commission requested that the EdFund Board of Directors not proceed with the salary survey during the August Commission meeting.
- D. *Inappropriate Department of Finance Position on Severance and Bonus Payments:* Commission staff stated that Finance indicated that they could accept a retention bonus for a more limited number of EdFund executives without consulting with the Commission about the need for severance agreements, retention bonuses, or salary increases to retain EdFund executives.

Results: Two issues were substantiated and two were unsubstantiated as follows:

A. *Pursuance of Severance and Bonus Payments: Unsubstantiated*

Based on OSAE's review, no activity related to severance or retention bonuses has occurred since at least July 2008 except for the salary survey discussed in Item C below. The next proposed salary increase per the EdFund Executive Compensation Policy will not occur until November 2008.

B. *Bagley-Keene Open Meeting Act and Fair Political Practices Act Violations: Substantiated*

The EdFund Board of Directors meetings on April 23, 2008, and May 14, 2008, were conducted in closed sessions with the attendance of the proposed severance package recipients present at the April 23, 2008 meeting. The EdFund Board Chair indicated that at the time they received legal guidance indicating that this was appropriate for the

meetings held. However, based on additional information provided after these meetings, the EdFund Board Chair agrees these meetings should have been open meetings instead of closed meetings. Based on OSAE's review, we are unaware of any other inappropriate meetings occurring after this issue was resolved in June 2008.

C. *Unauthorized Continuance of Salary Survey: Substantiated*

OSAE confirmed that the Commission requested the EdFund Board not to move forward with the salary survey. However, EdFund confirmed that it is moving forward with the survey this year. The September 2008 Commission meeting transcripts indicate the EdFund Board decided to move forward with the salary survey due to concerns that if it did not follow its standard practice that it could be subject to criticism later.

D. *Inappropriate Department of Finance Position on Severance and Bonus Payments: Unsubstantiated*

It is correct that Finance indicated that while it would not favor acceptance of the proposed severance agreements, it could accept a retention bonus for a more limited number of EdFund executives. This was presented as a general position that Finance held in June 2008. However, this was not an official action and was not based on any specific proposal that was made as an alternative to the severance agreements originally proposed. Furthermore, this statement was made at a meeting in which the EdFund Board Chair, the EdFund Board Finance and Budget Committee Chair, EdFund's outside counsel, prior Commission Chair, Commission's Program Planning and Budget Committee Chair, the Commission's general counsel, Finance's general counsel, and the Finance Director were present. Because no official action has yet been taken by Finance, any pertinent information could still be provided to Finance for consideration when requested to approve or disapprove salary recommendations in accordance with Senate Bill 89 (SB89).

2. Unapproved Request for Proposal for Policy Awareness and Advocacy Campaign Issued by EdFund

EdFund issued a request for proposal (RFP) for a high-profile policy awareness advocacy campaign without EdFund Board or Commission knowledge or approval. The Commission claims that the RFP reflects a public policy position that the Commission has not yet adopted related to the federal Direct Lending Program.

Results: Substantiated

The RFP was issued in accordance with contracting policies which did not require EdFund to communicate the RFP or obtain approval from the EdFund Board or Commission. However, this RFP represents a high profile public awareness campaign that supports the public policy position of using guarantee agencies as opposed to the direct lending program for providing student loans.

The Executive Parameters Policy 6, External Communications states that the EdFund President and their respective staffs will not take a position contrary to a position adopted by the Commission or represent interests contrary to those of the Commission. Currently, the Commission has not developed a public policy on this issue. Therefore, the EdFund's position was not contrary to the Commission's policy. However, because this was such a

high profile public awareness campaign that could be interpreted as Commission policy, EdFund should have brought this RFP to the attention of the EdFund Board and the Commission to obtain a decision on what the Commission's policy position would be relative to this issue. Because EdFund is a guarantee agency and has historically provided critical support to the Commission's state program operations and grant programs which benefited California students, it would seem that the Commission's position would be to support the guarantee agencies at least until EdFund is sold.

Based on a review of the RFP, the members of Congress and their staffs are one of three target audiences. Further, the RFP discusses the potential democratic support of eliminating the Federal Family Education Loan Program (FFEL) and have all student loans flow through the Direct Lending Program. The RFP also is looking for a firm that will create a grassroots campaign designed to influence behavior and attitudes. While EdFund management maintains that this is a promotion and marketing proposal, it gives the appearance of potential lobbying activities. As a result, the Commission, EdFund Board, and EdFund will need to carefully consider what public awareness activities are appropriate under state and federal law when deciding on its official policy position and activities that may be undertaken to support the official policy position.

3. United States Department of Education Concerns Regarding EdFund Management and the Voluntary Flexible Agreement

The United States Department of Education (USDE) continues to clearly indicate serious concerns about the EdFund President's previous tenure as administrator of the loan program, when he was executive director of the Commission, giving further contractual instruction that the Commission's oversight role is key in the USDE's continued approval of California's participation in the state's Voluntary Flexible Agreement (VFA).

Results: Undetermined

USDE was unwilling to discuss the concerns reported by the Commission.

Currently, the VFA has been submitted to the USDE. The Commission stated it is currently working with USDE to get it approved. However, the Commission indicated that USDE stated it was not planning to approve the VFA until the current events in California were resolved. Specifically, the Commission stated that USDE previously communicated concerns related to the EdFund President and expressed reservations related to the September 4-5, 2008 Commission meeting actions and subsequent overturning by Finance of several of the Commission's actions.

Both the Commission and EdFund are concerned about the finalization of this contract with USDE because each month of delay results in \$750,000 in lost revenues. The VFA allows EdFund to earn revenue by counseling students at risk for dropping out of school to stay in school and avoid defaulting on their loans. The USDE is negotiating new VFAs for all of the guarantee entities that wish to participate in this program due to requirements to ensure these agreements are cost neutral. To date, none of the new VFAs for any of the guarantee entities has been approved by the USDE.

Based on information provided to us, there were delays in coming to an agreement on the terms of the VFA. Specifically, after the EdFund President provided the draft VFA to the USDE, the USDE added some additional terms to the agreement. The Commission

believed that the changes were substantial while EdFund believed that the changes were minor and should not hold up processing the VFA. Furthermore, the Commission recommended revisions which included designating Finance as the party responsible for EdFund based on Finance's SB89 authority. Finance disagreed with this recommendation since the Commission is the designated student loan guarantee agency. Furthermore, it is anticipated that the USDE will not accept that term for the same reason.

4. EdFund's Unreimbursable Federal Default Fee Payments

EdFund is demanding payment from the Commission for expenditures involving a federal default fee scheme undertaken by EdFund in a manner inconsistent with federal law, and has, therefore, devalued EdFund by \$6 million.

Results: Substantiated

The amount in question is approximately \$8 million because the costs incurred during the last quarter related to the *Student's First: A Partnership for America's Future* default fee strategy was not reflected in the allegation. Based on OSAE's analysis, the federal default fee lender agreements included indirect inducements prohibited by federal regulations. Specifically, the lender agreements required the lender's to meet one of the requirements below for EdFund to pay all or a portion of the federal default fee on new loans:

- 80 percent of the lender's loans guaranteed by EdFund during the prior year were consolidation loans.
- Provide \$500 million in consolidation loan guarantee volume to EdFund, or at least 30 percent of total EdFund loan guarantee volume is comprised of consolidation loans.
- Amount reimbursed is based on the lenders performance during the first six months of the lender agreement.

5. EdFund Inappropriately Processed the Lender of Last Resort Contract

The Commission stated that the EdFund President signed a \$5 million contract for Lender of Last Resort Services without the approval of the EdFund Board or the Commission.

Results: Unsubstantiated

A review of the EdFund Procurement/Contracts policy in place at the time the contract was signed indicates that the EdFund President was authorized to sign contracts that were competitively bid without a dollar limitation and was not required to submit these contracts to either the EdFund Board or the Commission for approval.

Based on a review of documentation, there was extensive discussion between EdFund and Commission staff regarding obtaining lenders and other issues related to the implementation of the Lender of Last Resort Program. Further, there was general discussion about preparing to implement the advanced funding option, including development of a trailer bill, to enable EdFund to implement the advanced funding option if needed. While it wasn't a requirement to communicate the development and signing of this contract to the EdFund Board, the Commission, or Commission staff, it is unclear as to why the request for proposal and subsequent contract would not have been included in these discussions. Furthermore, it is unclear why EdFund would not have updated the EdFund Board and Commission on

the status of a contract that could jeopardize the guarantee agency designation if it is not obtained by the federal due dates. The revised procurement/contract policy, adopted at the September 4-5, 2008 Commission meeting, will require EdFund Board approval for competitively bid contracts over \$500 million. Additionally, EdFund will be required to obtain approval of the Commission General Counsel and the Federal Policy and Program Division staff for RFPs prior to issuance. This will ensure that the Commission will be aware of contracts that are in negotiation.

6. EdFund's Lease Obligation of \$1.3 Million for Empty Building

- A. *Lease Obligation for Empty Building:* EdFund Management signed a lease that obligated EdFund to pay up to \$1.3 million annually for an empty building until it finds a tenant.
- B. *Finance's Approval Delay Caused Excess Moving Costs:* Finance's delay in approving the lease authorization forms caused the Commission to have to pay the costs of moving twice.

Results: One item was substantiated and one item was not substantiated as follows:

A. *Lease Obligation for Empty Building:* Substantiated

When the lease was signed, the empty building was intended to be occupied by the Commission. This agreement was signed before the plans to sell EdFund were announced and was approved by the Commission. Currently, EdFund is looking for a new tenant and would prefer a tenant that could offer a ten-year lease commitment to the developer with the goal of being released from the obligations associated with the empty building. EdFund had previously located a tenant, but that tenant rescinded its offer in July 2008.

B. *Finance's Approval Delay Caused Excess Moving Costs:* Unsubstantiated

Based on a discussion with a Department of General Services (DGS), Real Estate Services representative, DGS usually needs 18 to 24 months notice to locate space and complete all the necessary procedures to get space ready for occupancy for an organization of the size of the Commission. In an emergency situation, DGS requires one year to locate a space and complete all the processes.

The State Administrative Manual Section 6453, states the normal Finance review of a Space Action Request and Estimate of Occupancy Costs is 30 days. Finance reviewed and approved the Commission's forms within 34 days of receipt. The forms requiring approval were submitted to Finance only six months prior to the expiration of the lease. Therefore, it appears likely that the Commission would have had to move twice based on the DGS time requirements.

7. EdFund Expenditures Represent a Waste of Public Funds

The Commission stated that the following spending by EdFund raises serious concerns about the waste of public funds.

- A. Coffee Services Contract for EdFund staff of \$93,000.
- B. Barbeque Pit Relocation Costs of \$1,500.
- C. EdFund Rebranding Contract for \$65,000.
- D. New Building Security System Costs in excess of \$400,000.

Results: Two issues were substantiated and two issues were unsubstantiated as follows:

A. *Coffee Services Contract for Employees:* Substantiated

A \$93,000 two-year contract was signed for coffee services at no charge to EdFund staff. The actual costs would be based on the actual use of the coffee services by EdFund staff. While this may be a common practice of other non-profit agencies with other funding sources, the Student Loan Operating Fund (SLOF) and Equity account are property of the state. Therefore, these funds are subject to both state and federal spending requirements.

The California State Constitution, Article XVI, Section 6 prohibits gifts of state funds. Providing free coffee to EdFund staff could be construed or interpreted as a gift of state funds. Furthermore, the Code of Federal Regulations, Section 682.423 states specific uses that the SLOF may be used for which include specific items such as application processing, loan disbursement, and default collection activities. One such use is other student financial aid-related activities for the benefit of students, as selected by the guaranty agency. This purchase does not meet that requirement because it does not benefit the students.

B. *Barbeque Pit Relocation Costs:* Unsubstantiated

EdFund originally purchased the barbeque pits and had them installed at the prior location. EdFund staff stated that the original cost of the barbeque pits was approximately \$15,000. EdFund provided documentation supporting that the cost to move the barbeque pits was approximately \$1,500. While the original purchase of the barbeque pits may not have been an appropriate purchase based on the state and federal criteria above, these assets were already in existence. Because the moving costs were immaterial, it appears that it was a reasonable decision to move these items with the rest of the EdFund property to the new location.

C. *EdFund Rebranding Contract:* Substantiated

EdFund has signed a \$65,000 contract for creative and design services to rebrand EdFund, including new logo and tag line updates and a redesign of EdFund's website. However, a new logo could either increase or decrease the value of EdFund depending on various market factors. Before a new logo is introduced, it is recommended that

EdFund, the Commission, and Finance consult with the entity selected to market and sell EdFund.

D. New Building Security System Costs: Unsubstantiated

EdFund stated that security is needed to maintain the safety of employees and reduce the risk of theft; reduce the loss of critical customer information, including disaster recovery; and to safeguard approximately three million social security numbers. EdFund provided a list of items related to both the physical and information technology security at the new building, which totaled approximately \$309,000. However, OSAE cannot determine whether the actual costs are reasonable without performing additional audit procedures. It is clear that both the Commission and EdFund maintain confidential records that must be adequately protected both physically and within the information technology infrastructure.

E. Other Expenditures

While this was not included in the concerns reported in the Commission's August 29, 2008 letter, during interviews Commission staff discussed concerns related to some items in the proposed budget including \$25,000 for an employee celebration event and approximately \$2,000 in costs related to a health fair, walking program and giveaways. The specific items related to the health fair and walking program events include the following:

- Pizza
- Biometric screenings and health risk assessments
- Tote bags
- Posters
- Massage therapy
- Engraved iPod
- Footlocker gift certificate

Results: Substantiated

OSAE verified that these items were included in EdFund's 2008-09 proposed budget. Additionally, the June and July 2008 invoices included staff recognition costs. While the budgeted items will require approval by the Commission when the 2008-09 EdFund budget is approved, it may indicate the need for an audit to determine whether other costs incurred by EdFund are unallowable under the state and federal guidelines.

8. Inappropriate Prevention of Outreach Funding

EdFund, in conjunction with Finance, continues to attempt to prevent the funding of the Commission's ongoing efforts to inform California's students and parents about paying for college, thus placing the state's student loan guarantee program in violation of federal law.

Results: Unsubstantiated

Funding for these activities was specifically disapproved by the Legislature during the fiscal year 2008-09 budget process. Therefore, it appears that Finance's disapproval was consistent with the Legislature's intent.

The Commission indicates that without the outreach funding requested, it will be unable to meet the federal outreach requirements. However, EdFund indicated that it performs more than the minimum outreach activities already. OSAE was unable to obtain information from USDE regarding the minimum outreach requirements in order to evaluate this portion of the concern.

9. Same Level of Support Services Provided to the Commission by EdFund

EdFund's continued refusal to provide the Commission with the same level of service support places the Commission's administration of the Cal Grant program at risk, both currently and in the future.

Results: Unsubstantiated

The Commission indicated that Commission and EdFund staff met to reach a compromise on the same level of service estimates. While the EdFund's estimate was lower than the Commission's proposal, EdFund staff did commit to support the Commission at the same level of service. Further, the Commission stated that additional discussions are taking place to determine whether or not EdFund will provide the service the Commission believes is needed.

Finance staff stated the expectation is that the 2008-09 fiscal year operating agreement would continue to fund the historic level of services that the Commission relied upon, less any activities directly funded in the Commission budget.

10. Finance Has Allowed EdFund Management to Circumvent Commission Authority

Finance has allowed EdFund management to not follow the established process by allowing EdFund to circumvent the Commission, policies of both the Commission and Finance, and the Articles of Incorporation under which the Commission formed EdFund.

Results: Unsubstantiated

Based on a review of discussions with EdFund, the Commission, Finance staff, the review of communications between Finance staff, Finance and EdFund staff, and Finance and Commission staff, it is apparent that EdFund has repeatedly contacted Finance directly for action on issues when disagreements between EdFund and the Commission occur. Additionally, on occasion, the Commission has also contacted Finance directly for a decision on issues before taking its own action. Various e-mail communications reviewed indicated that when Finance was requested to act on issues, Finance generally referred the requestor back to the established policy or inquired as to whether the issues were discussed with the other party. Furthermore, several communications between Finance staff indicated substantial reluctance to get involved in such issues. However, there was discussion about whether to get involved with some items due to the escalating disagreements between the Commission and EdFund. Upon occasion, Finance staff shared their views, but consistently

stated in e-mails to both parties that Finance would not take official action until the established processes were followed. Furthermore, it is appropriate that all parties share their views and work cooperatively with each other to ensure decisions are based upon the best available information. Therefore, OSAE recommends that when either EdFund or the Commission request assistance from Finance, the parties continue to be referred to the established processes. If the issues still cannot be effectively resolved, Finance, in its oversight role, may consider facilitating meetings that include all the relevant parties to assist EdFund and the Commission in reaching a resolution, and to ensure that Finance is fully informed before making decisions under SB89.

**EdFund
Allegations and Concerns**

EdFund reported the following allegations and concerns to the Department of Finance (Finance) in its September 2, 2008 and September 15, 2008 letters. Additionally, the EdFund September 2, 2008 letter included concerns related to the lender of last resort, Voluntary Flexible Agreement, and federal default fee payment issues. The information in the September 2, 2008 letter was incorporated into the review of the Commission concerns and the results are included in Appendix A.

1. Threats, Retaliatory Actions, and Hostile Work Environment Caused by the Commission

- A. *Hostile Work Environment*: The September 4-5, 2008 Commission meeting agenda, materials, corresponding press coverage, and meeting discussion represents threats, retaliatory actions, and creates a hostile work environment. Furthermore, they contain distortions or misrepresentations of facts aimed at compromising and casting aspersions on the character and reputations of EdFund's Board and management team.
- B. *Transition to Direct Lending Program*: At the September 4-5, 2008 Commission meeting, the Commissioners discussed how from a policy perspective they needed to prepare for the demise of the Federal Financial Education Loan Program (FFEL) and transition to the Direct Lending Program.
- C. *California-Only Focus*: At the September 4-5, 2008 Commission meeting, the Commissioners discussed how out-of-state business conflicts with and potentially impedes their California-only focus. This contradicts with the EdFund business model and the Operating Agreement.
- D. *Bagley-Keene Open Meeting Act Violations*: Leading up to and during the Commission's September 4-5, 2008 Commission meeting, there may have been violations of the Bagley-Keene Open Meeting Act.

Results: One of the items was substantiated and three were unsubstantiated as follows:

- A. *Hostile Work Environment*: Unsubstantiated

The disagreements and allegations by both parties is creating a very uncooperative work environment for both the Commission and EdFund staff. While many of the agenda items in the September 4-5, 2008 Commission meeting caused the EdFund staff to feel uncomfortable, the Commission is required to discuss significant items requiring decisions in accordance with the Bagley-Keene Open Meeting Act. Many of the items

discussed in the meeting are included in the Commission's concerns and allegations in Appendix A. It appears many of the issues above might have been resolved had the Commission and EdFund been able to openly communicate and work cooperatively to resolve the issues.

B. *Transition to Direct Lending Program*: Substantiated

Based on a review of the September 4-5, 2008 Commission meeting transcript, most of the discussion was related to the fact that the Commission should develop a policy related to public awareness. However, during the meeting, one Commissioner did indicate he had a discussion with the EdFund president regarding the Direct Loan Program and the FFEL Program and the effect on California and students if the FFEL Program was eliminated. During the meeting, this commissioner indicated he would appreciate a policy discussion about the benefits of the elimination of the FFEL Program because he thought it was an issue. The final motion adopted was to have a presentation about the FFEL and the Direct Loan Program so the Commission would be informed and could arrive at a policy position.

While it appears appropriate for the Commission to prepare for industry risks that could occur if the guarantee agencies lose some or all of their business due to the Direct Loan Program, it would be anticipated they would support the mission of their auxiliary organization, EdFund. Further, the Commission is charged with maintaining and/or increasing the value of EdFund. While the Commission may determine whether specific outreach is an appropriate action at this time in support of the EdFund, any activities planned should be in accordance with both state and federal expenditure requirements.

C. *California-Only Focus*: Unsubstantiated

Based on a review of the September 4-5, 2008 Commission meeting transcript, OSAE identified one statement made by a Commissioner indicating that taking EdFund nationwide has brought in more revenue, but the Commission's concern is California students. However, in reference to this issue, Commission staff provided California Education Code 69761 which states that to assist the greatest number of eligible resident students, the Commission is authorized to provide a source of loans to eligible students within and outside California. Furthermore, the additional EdFund revenue has provided funds to assist with other state student grant programs. While one statement was made to the effect noted above, the Commission staff recognize EdFund as a national organization which benefits California students.

D. *Bagley-Keene Open Meeting Act Violations*: Unsubstantiated

EdFund was unable to provide any specific dates or attendance at any meetings that would have violated the Bagley-Keene Open Meeting Act. Furthermore, Commission staff were unaware of any meetings that would have violated the Bagley-Keene Open Meeting Act. Based on a review of the August 29, 2008 Commission letter from the Commission and a review of the September 4-5, 2008 Commission meeting transcript and materials, the majority of the issues were previously identified as concerns of the Commission. Additionally, the Commission staff generally prepare and present the analysis of the issues, approved by the Commission Chair, for discussion by the Commissioners. This interaction during the meeting and in preparation for the meeting could cause the appearance that meetings may have been held even if they were not.

Further, it may be a good idea for EdFund staff to provide analysis materials related to the agenda to ensure all views of the issues are represented providing the Commission all available information from which to make informed decisions.

2. Violation of State Protocols for Leasing Office Space

The Commission may have circumvented state protocols for the leasing of office space at 1130 K Street.

Results: Unsubstantiated

The 1130 K Street office space is occupied by Commission staff. However, in the past, EdFund had signed the lease agreement for the Commission to occupy this office space. Based on a discussion with the Department of General Services, it appears this was not a circumvention of state protocols because EdFund has the authority to enter into contracts and can offer a sublease to the Commission. However, the Commission is working with the Department of General Services to process the current lease renewal directly with the Commission instead of EdFund. This is because it is better to minimize EdFund's direct liabilities in preparing EdFund for sale.

3. Cash for College Workshops Provided Solely in Democratic Regions for the Executive Director's Own Political Favor

The Commission's Executive Director may have been using the Cash for College Workshops as a vehicle to promote Democratic legislators/leadership solely in Democratic regions for her own political favor.

Results: Unsubstantiated

We reviewed documents provided by Commission staff regarding the Cash for College Workshops and it appears that all state legislators are encouraged to participate in the Program. Based on information provided, the Democratic legislators had a higher participation rate than the Republican legislators.

The Commission describes the Cash for College program as a partnership between high schools, college campuses, various outreach programs including Cal-SOAP, businesses, and government agencies. To develop a list of targeted schools for the Cash for College program, the Commission enlisted the University of California All Campus Consortium on Research for Diversity (ACCORD). The list of targeted schools was based upon economic status, parent educational attainment, student to high school counselor ratios, and historically low financial aid application rates. The Commission indicated that selected workshop locations were based on the ACCORD list of schools and it was coincidental that many lower income districts have Democratic representation. Additionally, information was provided indicating that Republican legislators participated in some of the Cash for College Workshops.

4. Commission Circumvention of State Contracting Protocol

The Commission may be circumventing state protocol by daisy-chaining contracts for certain contractors.

Results: Unsubstantiated

Based on a review of the Commission's contract list for July 1, 2005 through June 30, 2008, it does not appear the Commission is daisy chaining (continually giving sole source contracts to specific vendors) any contracts.

5. Commission Churning of Personnel Vacancies

The Commission may have misrepresented, underestimated, or underreported personnel vacancies by churning Commission grant staff and reclassifying EdFund loan program civil service vacancies as Commission grant staff vacancies.

Results: Undetermined

EdFund did not provide any specific data to support this allegation. The Commission only provided an explanation related to the approved shifting of position authority from EdFund to the Commission for grant administration work in 2005-06. Based on the information received, we cannot conclude on whether any personnel vacancies were misrepresented, underestimated, or underreported by reclassifying EdFund loan program civil service vacancies as Commission grant staff vacancies.

6. Diversion of Salary Savings to Non-Personnel Expenses

The commission has historically maintained a significant number of vacant positions, and may be diverting the corresponding personnel funds to cover other non-personnel expenses.

Results: Unsubstantiated

EdFund did not provide any specific data to support this assertion. OSAE confirmed that the Commission utilizes a program budget which allows it to use salary savings for operating expenditures.

7. Operating Agreement Violations by the Commission

The Commission has consistently violated numerous provisions of the Operating Agreement including the following:

- A. *July Joint Workshop:* The July Joint Workshop was not held between the Commission and the EdFund Board to review the EdFund Budget, Business Plan, and Goals.
- B. *Untimely Reimbursement of Expenses:* The Commission has not followed the contractual requirements for timely reimbursing EdFund expenses.
- C. *Inappropriate Report Development Process:* The Commission is constantly developing new reports without going through the identified process.

- D. *Annual Oversight Plan not Provided*: The Commission has never provided EdFund with an Annual Oversight Plan.
- E. *Refusal of Commission to hold Joint Resolution Meeting*: The Commission has refused the request for a joint meeting for dispute resolution related to the federal default fee issue.

Results

A. *July Joint Workshop*: Substantiated

The Commission indicated that the July Joint Workshop was not held because the Commission could not obtain a quorum of the Commissioner's which is required to hold the meeting. Additional attempts to reschedule the meeting were unsuccessful due to unavailability of EdFund Board and/or Commission members.

B. *Untimely Reimbursement for Expenses*: Substantiated

This issue is related to the unreimbursable federal default fees and monthly invoices. The payment issue related to the federal default fees is discussed in the Commission allegations and concerns in Appendix A. Based on a review of the June and July monthly invoices, the June invoice was submitted on June 16, 2008 and was authorized for payment on August 20, 2008. The July invoice was submitted on August 14, 2008, and authorized for payment on September 15, 2008. For both of these invoices, a portion was not authorized for payment pending resolution of further Commission review. The operating agreement states that payment of invoiced expenses shall be made within thirty days of receipt of all necessary documentation. Based on the OSAE's review, approved expenses for both invoices were authorized after the 30 day requirement and would have still required time to process the payment. The Commission claims that a more thorough review of invoices is required because previously EdFund was billing based on accrued versus actual expenditures. Additionally, the expenditures are now being reviewed in more detail to ensure that they are appropriate. Furthermore, the Commission stated that due to budget cuts, staffing is inadequate to perform some of the EdFund oversight responsibilities.

C. *Inappropriate Report Development Process*: Undetermined

EdFund did not provide any specific examples of reports that did not follow the identified process. When this was discussed with the Commission, it indicated that it did not request excessive reports outside of the process. Additionally, it stated that many of the reports required by the 2007 Annual Oversight Plan were currently not being produced. In order to conclude on this allegation, further audit procedures would need to be performed. However, instead, OSAE recommends the Commission and EdFund meet to discuss the reports in question and arrive at a solution that meets the needs of both organizations.

D. *Annual Oversight Plan not Provided*: Substantiated

The 2007 Annual Oversight Plan was adopted on September 6, 2007. No information was provided related to a 2008 Annual Oversight Plan. The Operating Agreement

requires that the Annual Oversight Plan be prepared no later than May 15 of each year and adopted by the Commission no later than September 30 of each year.

E. *Refusal of Commission to Hold Joint Resolution Meeting*: Substantiated

A dispute resolution meeting was not held to discuss the resolution of the unreimbursable federal default fees. However, at the time of the request, the Commission understood that the EdFund Board Chair was discussing whether the EdFund Board would agree to rescind the invoices at the August 15, 2008 EdFund Board meeting. Therefore, the Commission believed the issue was being resolved and the joint meeting was not required at that time. Further information regarding the resolution of the unreimbursable federal default fee payments is discussed in Appendix A.

8. Commission Release of Confidential and Proprietary Documents to the Press and/or Public without Prior Consultation with EdFund.

The Commission and the Executive Director have consistently ignored confidential and proprietary statements that are on official EdFund documents when releasing those documents to the press and/or public without prior consultation with EdFund.

Results: Unsubstantiated

EdFund did not provide a list of documents that it believes were released to the press except for the Change in Control Severance Agreement. However, OSAE could not confirm how this document was made available to the press. Therefore, this allegation could not be substantiated.

9. Commission Spending of Unbudgeted and Unauthorized State Funds

The Commission may have spent unbudgeted and unauthorized funds through improper reporting of expenses in the California State Accounting and Reporting System.

Results: Undetermined

In order to evaluate this area, significant resources will be required to perform the necessary audit procedures. However, the Commission indicated that some of the differences might be because the Commission is on a July 1 through June 30 fiscal year and EdFund's fiscal year is from October 1 through September 30.