
4.1

Information Item

Joint Grants and Programs Committee & Fiscal Policy and Long-Range Planning Committee

Cal Grant Disbursements/Advance Payments/Reconciliation Processes and Proposed Changes

Over the past six months, Commission staff has been reviewing the current Cal Grant disbursements, advance payments and reconciliation processes and considering changes that would make these processes consistent with accepted state standards and ensure the Commission's fiduciary responsibility. In addition, the Commission's Internal Audit Division has initiated the first of several internal audits of the Cal Grant Program, Information Security Program, and Outreach/Public Awareness Activities. The first of these internal audits on the Cal Grant Disbursements and Reconciliation Process has now been completed with several key findings and recommendations to, among other things, strengthen the Commission's processes.

This presentation is designed to provide an overview of each of these processes and present options for changing these processes to ensure the Commission's fiduciary responsibility over state funds and respond to the internal audit findings. A similar presentation will be provided to the Commission's Grant Advisory Committee at its March meeting with the anticipation of bringing final recommendations for changes to the Commission in April for action.

Recommended Action: For information only. No action is required.

Responsible Staff: Max Espinoza, Chief
Program Administration & Services Division

Janet McDuffie, Chief
Management Services Division

John Bays, Chief
Information Technology Division

Diane Manning, Vice President
Audit Services

Anne Robertson, Manager
Cal Grant Operations Branch

Robert Illa, Manager
Fiscal and Administrative Services Branch



Cal Grant Disbursement and Reconciliation Review

December 30, 2005

Audit #05-301

TABLE OF CONTENTS

| <u>Section</u> | <u>Page</u> |
|---|-------------|
| I. Executive Summary..... | 2 |
| II. Objectives, Scope and Methodology..... | 5 |
| III. Process Overview..... | 7 |
| IV. Key Audit Procedures..... | 12 |
| V. Findings, Recommendations and Management’s Responses..... | 20 |
| VI. Implementation Plan for Recommended Actions..... | 27 |
| <i>Appendix A – Process Flow Diagrams.....</i> | <i>28</i> |
| <i>Appendix B – Institutional Participation Agreement (IPA)</i> | <i>32</i> |

I. Executive Summary

The Cal Grant Operations Branch within the California Student Aid Commission (CSAC) is responsible for administering the operational activities for those state funded grants referred to as Cal Grants with support from the Fiscal and Administrative Services Branch and the Information Technology Services Branch. Cal Grants are awarded to eligible students whose family's income and assets are at or below a predetermined ceiling set by the State in accordance with the provisions of the California Education Code section 69432.7(k). These grants are designed to assist students in paying post-secondary education related expenses such as tuition, fees, books, supplies and living expenses.

The Cal Grant program has grown tremendously over the years, which is evident by the increasing amount of funds distributed to Cal Grant recipients each year. For example, in 1994 CSAC disbursed approximately \$234 million in Cal Grant funds. This amount increased to \$450 million in 2000 as program requirements were changed to include entitlement grants. For the fiscal year ended June 30, 2005, approximately 370 institutions qualified to participate with CSAC in distributing assistance to over 240,000 Cal Grant recipients, totaling approximately \$724 million in state funds. As a result of this growth, CSAC has recognized a need to reevaluate and modify its current practices as needed.

Two key functions of the Cal Grant Operations Branch and the Fiscal and Administrative Services Branch are the disbursement and reconciliation of Cal Grant funds. CSAC advances funds to the participating institutions shortly before, or at the beginning of, each term (semester or quarter). The amount of the advance is based on the total payments disbursed to all Cal Grant recipients for the same term in the previous award year, as reported to CSAC by the institution, less any unused funds previously advanced during the award year. An award year is the period beginning July 1 through June 30. However, the year is not closed for accounting purposes by CSAC for an additional six months, allowing the institutions additional time to record any unreported payments and adjustments to the Grant Delivery System (GDS) and for CSAC to prepare invoices to the schools for any excess funds that have not yet been remitted back to the State.

Institutions typically apply the funds advanced by CSAC first to the Cal Grant recipient's student account maintained at the school for amounts owed directly to the institution (i.e. tuition, fees, campus housing, etc.). In addition, for certain types of grants, the institution then cuts a check to students for books, supplies, and living expenses. The school is subsequently responsible for reporting to CSAC the amount disbursed for each Cal Grant recipient. CSAC is responsible for monitoring, reconciling, and auditing any differences between total school advances and the amounts disbursed on behalf of each Cal Grant recipient attending the school.

The reconciliation of Cal Grant funds is performed by CSAC through the GDS twice a month and at the end of December following the close of the award year. The twice monthly reconciliations compare the total each institution reported to CSAC as disbursed to Cal Grant recipients against the amount advanced by CSAC to date during the award year. If the amount disbursed by the institution exceeds the amount advanced, a supplemental payment equal to the difference is issued to the institution. In December, at the close of the award year, a final reconciliation is prepared by CSAC. In January, CSAC staff then invoice the institutions for any amounts disbursed to the institutions that exceed the amount reported as paid to Cal Grant recipients. The amount invoiced to schools expected to be refunded to the State for the recently concluded 2004 - 2005 award year was \$2.7 million.

Participating schools also remitted an additional \$2.7 million in excess funding back to CSAC prior to the invoicing process.

The Internal Audit Plan for the two year audit cycle ending December 31, 2007 identified the Cal Grant disbursement and reconciliation functions as areas of potential high risk due to the significant transaction and dollar volumes, in addition to the statutory requirements, the complexity of systems and processes utilized, and the inherent risk involved in making disbursements.

Beginning in October through December 2005, Internal Audit conducted a review of the key activities performed by the Cal Grant Operations Branch and the Fiscal and Administrative Services Branch in disbursing and reconciling Cal Grant funds. In carrying out this effort, Internal Audit reviewed the internal controls and evaluated the efficiency and effectiveness of the two branches' procedures and practices currently used to administer these functions.

Many of the current practices and processes used to administer the Cal Grant Program are documented in the Cal Grants Manual developed by CSAC staff and are intended to be followed by both CSAC and the participating schools. In consultation with the Grant Advisory Committee (GAC), CSAC has developed policies and regulations to carry out the Cal Grant Program as outlined in the Education Code. GAC, which is comprised of 20 members from public and private postsecondary institutions, financial aid administrators, and K-12 school representatives, is responsible for reviewing and providing recommendations to CSAC on major Cal Grant program and policy changes.

During this review, Internal Audit noted three long-standing practices which make the Cal Grant Program difficult to administer and creates inefficiencies (equating to higher costs) and significant risks to the State as follows:

- The amount advanced to schools prior to the start of a new term is not based upon the actual Cal Grant recipients registered to attend the institution for that term but rather upon an amount reported by the school as having been disbursed to all Cal Grant recipients during the same term in the prior year. The prior year disbursement used in this calculation is often not a final adjusted amount. (See additional information in the bullet that follows.) This methodology results in greater disbursements to schools and subsequent refunds to CSAC since advances are not based upon historical information and do not take into consideration the actual enrollment for the current academic year.
- Schools are not required to timely report amounts disbursed to Cal Grant recipients and make any necessary adjustments. The minimum required reporting to CSAC by the schools may occur as late as three and a half months following the end of an award year. An advance to a school made in August for the fall term is not required to be reconciled against actual disbursements to Cal Grant recipients and reported to CSAC until thirteen and a half months later on October 15th of the following year.
- Schools are allowed to hold excess Cal Grant funds for several months before CSAC offsets such amounts against advances to the schools for subsequent terms within the same award year or before the institutions return such funds to CSAC. Schools are not required to maintain the funds in interest bearing accounts nor are standard processes in place for CSAC to track and monitor the return of interest earnings to the State.

Internal Audit identified several opportunities to strengthen internal controls and improve business processes, many of which will require changes to the long-standing business practices described above. The opportunities are summarized as follows:

1. Reassess the current methodology of issuing advances and supplemental disbursements to institutions in an effort to improve cash flow for the State.
2. Require institutions to report disbursements and make adjustments prior to the published reporting deadline for each award year. Also, consider implementing additional reporting deadlines at the conclusion of each term.
3. Require institutions to maintain Cal Grant funds in an interest bearing account. Additionally, modify the Grant Delivery System (GDS) to track interest remitted by institutions and develop formal procedures to ensure schools are remitting interest earned on Cal Grant funds.
4. Modify GDS to allow the recording of all refunds from institutions related to a closed award year. Develop formal procedures to require that refunds recorded in CALSTARS (the State's accounting system) be reconciled to GDS and any differences resolved.
5. Document and reinforce established procedures to require institutions to remit all payments directly to the Fiscal and Administrative Branch. Currently, institutions occasionally send payments related to audit findings to the Program Compliance Branch.
6. Implement invoicing and follow-up procedures for collecting amounts owed to CSAC that are consistent with the guidelines defined in the State Administrative Manual (SAM).

CSAC Management notes that any major policy changes to Cal Grant processing may be brought to GAC for review and consultation prior to Commission action and implementation. CSAC staff will also need to amend the Cal Grant Manual to provide clear guidance to the financial aid offices.

Detailed information describing the six recommendations is provided in Section V of this report. The objectives, scope, methodology and key audit procedures used in Internal Audit's effort, along with the findings, recommendations, management's responses and an implementation plan are presented in the remainder of this document. Process flow diagrams depicting the disbursement and reconciliation process activities performed by the Cal Grant Operations Branch and the Fiscal and Administrative Branch is included in Appendix A. Additionally, a copy of the Institutional Participation Agreement (IPA), which defines the school's responsibilities for participating in the Cal Grant program, is included in Appendix B.

II. Objectives, Scope and Methodology

The key objectives tested during the Disbursement and Reconciliation Review include the following:

- Determine if Cal Grant advances are calculated in accordance with CSAC's procedures and if the current advance amounts issued are warranted.
- Ensure supplemental disbursements are properly calculated.
- Evaluate compliance with the timeframes defined in the Institution Participation Agreement for school reporting of payments and adjustments.
- Validate that disbursements made by CSAC to institutions are properly posted to CALSTARS.
- Ensure that Cal Grant funds not disbursed by institutions for a specific award year are returned to CSAC in a timely manner. Evaluate the procedures for collecting amounts owed from institutions for compliance with statutory requirements.
- Verify that refunds received from institutions are accurately reflected in CALSTARS and GDS.
- Validate that interest earned on Cal Grant funds not yet disbursed by the institutions is remitted to CSAC.

The scope of this review focuses primarily on key activities performed by the Cal Grant Operations Branch and the Fiscal and Administrative Services Branch in processing disbursements and reconciling Cal Grants. These activities include advancing funds, processing disbursements made by institutions, issuing supplemental disbursements, posting disbursements to the accounting system, reconciling and invoicing, and processing refunds from institutions.

A review of the eligibility of Cal Grant recipients and CSAC's compliance with the provisions of the Institutional Participation Agreement (IPA) are not included in the scope of this review, but are planned to be the subject of future reviews conducted by Internal Audit. Additionally, Internal Audit did not perform procedures during this review to test the accuracy of the disbursements and adjustments reported to CSAC by the institutions or their compliance with the provisions of the IPA as CSAC's Program Compliance Branch is responsible for performing such test work.

To meet the aforementioned objectives, Internal Audit examined relevant supporting documentation provided by CSAC, performed tests of recalculations, observed procedures and conducted interviews with the individuals listed in Exhibit 1 on the page that follows.

Exhibit 1: Personnel Interviewed

| Staff | Title - Branch | Division |
|------------------|---|--|
| Max Espinoza | Division Chief | Program Administration and Services Division |
| Anne Robertson | Financial Aid Manager – Cal Grant Operations Branch | Program Administration and Services Division |
| Damian Scribner | Associate Financial Aid Analyst – Cal Grant Operations Branch | Program Administration and Services Division |
| Jessica Duckens | Associate Financial Aid Analyst – Cal Grant Operations Branch | Program Administration and Services Division |
| Bev Kerth | Financial Aid Analyst – Cal Grant Operations Branch | Program Administration and Services Division |
| Robert Illa | Staff Services Manager – Fiscal and Administrative Services Branch | Management Services Division |
| Gina Heath | Senior Accounting Officer – Fiscal and Administrative Services Branch | Management Services Division |
| Mishelle Aldrich | Accounting Technician – Fiscal and Administrative Services Branch | Management Services Division |
| Edna Ong | Research Program Specialist – Research and Policy Analysis Branch | Governmental and Public Affairs Division |
| John Bays | Division Chief | Information Technology Division |
| Chris DeBortoli | Associate Program Analyst – Application and Database Support Branch | Information Technology Division |
| Penni Doud | Senior Programmer Analyst – Application and Database Support Branch | Information Technology Division |

Source: Internal Audit Department, October – December, 2005

III. Process Overview

The California Student Aid Commission (CSAC) is responsible for administering various grant programs for students attending public and private universities, colleges, and vocational schools in California. The Cal Grant Operations Branch within CSAC is responsible for administering the operational activities for those state funded grants referred to as Cal Grants with support from the Fiscal and Administrative Services Branch and the Information Technology Services Branch. Two key functions in administering the Cal Grant program are the disbursement and reconciliation of Cal Grant funds. The activities associated with these functions are described below.

Advancing Cal Grant Funds

As part of administering the Cal Grant program, CSAC advances money to participating Cal Grant schools to make funds available to students prior to the beginning of the term (semester or quarter). A participating Cal Grant school must be providing instruction in California, be a public post secondary educational institution or a private institution meeting federal guidelines. Additionally, the school must complete an Institutional Participation Agreement (IPA) with CSAC every four years. The IPA defines the school's responsibilities for participating in the Cal Grant program.

Per California Education Code section 69432.8, "The Commission may, on the basis of institutional academic calendars, advance, per term to authorized postsecondary educational institutions, the funds for eligible students who have indicated they will attend those institutions, less an amount based on historical claim enrollment attrition information". It has been CSAC's practice (for over ten years) to advance 95% of the amount that was disbursed to Cal grant recipients by the institution for the same term in the previous academic year. The previously disbursed amounts are tracked by academic year in CSAC's Grant Delivery System (GDS).

Institutions receiving Cal Grant monies are permitted to maintain those funds in either an interest-bearing or non-interest bearing account. If the funds are in an interest bearing account, all interest earned on the funds must be returned to CSAC, however the IPA does not specify the timeframe as to when the interest must be remitted back to the State.

Throughout the award year, the institution credits the Cal Grant recipient's account at the school or disburses the funds directly to the student for paying college related expenses, such as tuition, fees, books and supplies, and student living expenses. An award year is the period beginning July 1st through June 30th. However, schools are given an additional six months to report any and all payments and adjustments related to the entire award year. If a school did not participate in the Cal Grant program during the previous academic year, the school must report to CSAC an estimate of the cost for the student to attend the institution and any disbursements already made to the student prior to CSAC disbursing the funds.

Reporting Disbursements

Each year, CSAC utilizes information from each student's Free Application for Federal Student Aid (FAFSA)¹ and school verified grade point average (GPA) to create a Cal Grant roster in GDS for each institution. The roster lists the eligible Cal Grant recipients who plan to attend or return to the school for the specified award year and their associated award amount. Each student eligible for a Cal Grant award is placed on the roster of the first participating California school listed on the student's FAFSA.

Since 2002 institutions have had the ability to update their Cal Grant roster using WebGrants, a web-based application hosted by CSAC that allows authorized users at the schools to access GDS using the internet. Institutions utilize WebGrants to report to CSAC all disbursements made on behalf of the Cal Grant recipients by posting transactions on their Cal Grant roster throughout the award year. In addition to payment transactions, institutions may also update their Cal Grant roster when students transfer to or from their school or changes their enrollment status (full-time to part-time). Additionally, in the fall of 2005, students were provided access to an online application called WebGrants For Students to view their current grant status and grant history, as well as update their address or change their school of attendance.

Processing Disbursements Made by Institutions

The weekly GDS production cycle processes the transactions electronically reported by institutions during the week and updates the grant rosters accordingly. An Accept/Reject Report that contains summary and detailed information on both the accepted and rejected transactions is produced for each institution and made available to the schools through WebGrants. Typical reasons that transactions are rejected by the system include the following: the institution has not reported unmet financial need for renewal students to CSAC, the student has already received Cal Grant funds from another school during that term, or the payments reported by the school for that student exceed the award amount.

Staff in the Cal Grant Operations Branch review the rejected transactions from each week and make corrections where there is sufficient information to allow them to do so. GDS maintains a history of the changes and the user identification of the individual making the update. The schools, however, are ultimately responsible for reviewing the reject report each week, resolving the errors, including making necessary corrections in WebGrants, and resubmitting the transactions for processing during the next weekly reporting cycle. Cal Grant Operations staff represented that nearly all rejected transactions are corrected within a week.

¹ FAFSA is a federal form that must be filed by any student who wants to be considered for financial aid. The form reports household and financial information as well as the student's choice of schools. The FAFSA is the foundation document for all federal need analysis computations.

Issuing Supplemental Disbursements

Twice a month, GDS processes the accepted transactions from the weekly production cycle described above and updates the total amounts reported by each institution for the term. GDS also produces a Payment Activity Report summarizing all disbursements to the institution and the total reconciled payment transactions reported from the school for the award year. If the total amount reported by the institution as being disbursed to Cal Grant recipients for the term exceeds the amount advanced for that term, additional funds will be sent to the school (referred to as a “supplemental payment”). GDS then creates a file of supplemental payments, which is reviewed by the Associate Financial Aid Analyst in the Cal Grant Operations Branch to verify that the total amount of supplemental payments is correct and the files are properly formatted for subsequent processing. Next, GDS generates a claim schedule which is a detailed listing of supplemental payments to be disbursed by institution. The Associate Financial Aid Analyst sends the Associate Programmer Analyst in CSAC’s Information Technology Services Division (ITSD) an e-mail requesting the file of supplemental payments be transferred to tape at the State of California’s Stephen P. Teale Data Center (Teale Data Center). The Associate Financial Aid Analyst then signs the claim schedule, records the tape reel numbers on the document and forwards it to CSAC’s Fiscal and Administrative Services Branch Manager for approval. The approved claim schedule is sent by courier to the California State Controller’s Office (SCO), authorizing payment to the schools. SCO staff access the tape at the Teale Data Center using information on the claim schedule and generate the warrants or electronic fund transfer (EFT) to the schools. The next day, the SCO sends CSAC an email confirming that the claim schedule and payment tape were received and processed. The Associate Financial Aid Analyst sends an email notifying ITSD staff to initiate the GDS process that generates an email to the schools informing them that they should be receiving their EFT funds.

Recording Disbursements to the Accounting System

The Fiscal and Administrative Services Branch is responsible for recording all Cal Grant disbursements into CALSTARS, the statewide accounting and reporting system. The Senior Accounting Officer initially records the disbursement amount from the claim schedules to a suspense account (Grant Streamlining Account) in CALSTARS because the claim schedule does not provide a detail of the amounts disbursed by type of grant (e.g., Cal Grant A, B or C). At the end of each month, the Associate Financial Aid Analyst provides the Senior Accounting Officer with the GDS Payment Activity Report which details the specific amount disbursed for each of the three Cal Grant programs. The Senior Accounting Officer then reverses the amounts in the Grant Streamlining Account and applies the amounts to the specific Cal Grant program accounts in CALSTARS.

Year-End Reconciliation and Invoicing

The Cal Grant Institution Participation Agreement between CSAC and the schools requires institutions to make all disbursements to Cal Grant recipients no later than September 30th following the end of the award year. Any institution in possession of Cal Grant funds that have not been disbursed to students after that date is required to return those funds to CSAC. The institutions are then required to report to CSAC those amounts disbursed to Cal Grant recipients no later than October 15th following end of the award year. However, if at any time during the award year, an institution determines that they have excess Cal Grant funds, schools are encouraged to refund the money back to CSAC’s Fiscal and Administrative Services Branch prior to the end of the award year.

Each year, during the first week of November, the Cal Grant Operations Branch obtains copies of all refund checks remitted by the institutions during the award year and the months that follow from Fiscal and Administrative Services. Staff review the checks to ensure that the payments were posted correctly to GDS. Each year in December, a report is run to determine the final account balance owed from each institution. ITSD staff create draft invoices for those institutions with outstanding balances owed to CSAC. Cal Grant Operations staff review the draft invoices for reasonableness. In January, ITSD then prints the final invoices along with a cover letter stating the award year to which the invoice relates, the amount owed and a request to remit the payment to CSAC within 30 days. Once the cover letters and invoices are mailed, Cal Grant Operations staff run weekly queries on GDS to monitor which institutions have paid their invoice. Staff periodically call those institutions that have not remitted payment. Internal Audit noted that out of the 139 institutions invoiced for the 2003-2004 award year, 116 paid within 60 days of being invoiced. Additionally, as of December 2005, the date which Internal Audit concluded the test work for this review, approximately \$102,000 of the \$3.6 million invoiced related to the 2003-2004 award year remained outstanding from seven institutions.

The Cal Grant Operations Branch and the Fiscal and Administrative Services Branch recently proposed a new strategy to improve the invoicing procedures and the collection of outstanding invoice balances. This proposal is currently being evaluated for approval by CSAC management. A few highlights of this proposal are listed below:

- Newly developed, short-term procedures have been implemented to improve the invoicing process. These short-term procedures include a revised cover letter detailing the institution's responsibilities and mailing a copy of the invoice and cover letter to the financial aid office as well as the fiscal office rather than one, institutionally designated, contact.
- Issuance of 30 day past due notice – A notice will be sent to those institutions who have not paid within 30 days of being invoiced. This notice warns the institution that all processing of Cal Grant transactions will cease if the balance is not paid within 30 days of the notice. This notice and following notices will be sent to the institution's chief executive officer. In addition CSAC staff will make follow-up telephone calls to the institution.
- Issuance of 60 day past due notice – If an institution has not remitted payment within 60 days of being invoiced, a notice will be sent to notify the school that CSAC has ceased processing all Cal Grant payment transactions. This notice warns the institution that future term advances will be withheld if the balance is not paid within 30 days of the notice.
- Issuance of 90 day past due notice – If an institution has not remitted payment within 90 days of being invoiced, a notice will be sent to notify the school that CSAC will withhold term advances for future academic years. Additionally, the notice warns the IPA will be terminated in 30 days if the invoice is not paid.
- Issuance of 120 day past due notice – If an institution has not remitted payment within 120 days of being invoiced, a notice will be sent to notify the school that their IPA has been terminated and the school is no longer eligible to administer the Cal Grant Program. The Cal Grant students attending the now ineligible institution will be sent a letter and appropriate forms to request a school change or leave of absence.

Receiving and Processing Refunds from Institutions

Daily, the EDFUND Mail Center delivers mail from CSAC's post office box to the Fiscal and Administrative Services Branch. The branch's Office Technician opens the envelopes and removes the refund checks along with any supporting documentation. The checks are logged into an Excel spreadsheet which lists the following items: date received, maker, bank routing number, check account number, payee, check date, check number and amount. The checks are then photo copied and date stamped. All checks and copies are then hand delivered to the Accounting Technician.

The Accounting Technician then runs an adding machine tape of the checks and restrictively endorses each check with an endorsement stamp. The Accounting Technician generates a State Treasurer's Office deposit slip. The checks and deposit slip are then hand carried to a Senior Accounting Officer who verifies the deposit total and that all the checks are endorsed, and then initials the deposit slip. The Accounting Technician puts the checks and deposit slips in an envelope then gives the deposit envelope to the EDFUND mail courier who takes the deposit envelope to EDFUND's Finance and Administration Division. The deposit envelope is placed in a sealed bank deposit bag and then picked up by a courier. The courier delivers the sealed deposit bag to the bank where the funds are subsequently transferred to the State Treasury. The Accounting Technician records the refund in CALSTARS files check copies and deposit slip copies. The Office Technician updates the Excel spreadsheet with the deposit slip number.

If the check is not for a payment of an invoiced amount or a Program Compliance Branch audit finding, the Accounting Technician contacts the Associate Financial Aid Analyst to research the nature of the payment. The Associate Financial Aid Analyst researches GDS to determine the award year to which the payment applies. If the payment relates to the current award year and GDS reflects an outstanding balance for the institution, the Accounting Technician applies the payment to GDS and CALSTARS. If GDS does not reflect an outstanding balance due from the institution, whether the academic year is open or closed, the check is recorded as an abatement in CALSTARS and the institution's account is not updated in GDS. The payment information is recorded in the individual student's file and program eligibility is increased or decreased as applicable.

IV. Key Audit Procedures

Numerous audit steps were completed by Internal Audit to review the internal controls and evaluate the efficiency and effectiveness of procedures and practices currently used to carry out activities associated with disbursing and reconciling Cal Grants. Key audit procedures executed along with the results are presented in Exhibit 2 below and on the pages that follow.

Exhibit 2: Key Audit Procedures Performed and Test Results

| Audit Objective | Key Procedures Performed | Results |
|---|---|--|
| <p>A. Determine if Cal Grant advances are calculated in accordance with CSAC's procedures and if the current advance amounts issued are warranted.</p> | <p>Obtained the following:</p> <ul style="list-style-type: none"> ▪ Grant Payment Extract files containing the disbursements reported by institutions from GDS for 2003-2004 and 2004-2005 award years. ▪ Grant Advance Table containing the payments CSAC made to institutions from GDS for 2003-2004 and 2004-2005 award years. ▪ Payment Activity Report showing disbursements made by institutions and by CSAC to institutions for the fall term of the 2004-2005 award year <p>A.1 Using audit analysis software (ACL), summed the total each institution reported as disbursed to Cal Grant recipients for the spring term in the 2003-2004 award year.</p> <p>Calculated the advance amount for each institution for the 2004-2005 spring term by multiplying the total each institution reported as disbursed for the spring term of the prior award year by 95%, and then subtracted any balance remaining from the previous term advance in the institution's account for the same award year. Compared the calculated amounts to the actual amount advanced to each institution for the spring 2004-2005 term.</p> | <p>A.1 The advance amount calculated by Internal Audit agreed to the amount CSAC advanced to the institutions during the spring term for all but five of the 350 institutions tested. The five cases where differences were identified are documented below.</p> <ul style="list-style-type: none"> ▪ Two of the five instances, were related to a new CSU campus that had previously operated as an extension campus of another CSU campus. After considering the payments reported by the two campuses collectively, Internal Audit was able to recalculate the amount advanced by CSAC. ▪ In the third instance, Internal Audit reviewed documentation |

Disbursement and Reconciliation Review

| Audit Objective | Key Procedures Performed | Results |
|-----------------|--------------------------|---|
| | | <p>sent to CSAC by a CSU campus requesting an advance above the standard 95% amount for the spring 2005 term. The institution represented to CSAC that the current advance level would not be sufficient based on their projected attrition and enrollment estimates and would likely cause delays in disbursements to their students. Internal Audit reviewed the documentation indicating that Cal Grant Operations Staff analyzed the amounts the institution had disbursed in the previous term, which appeared to warrant the increase requested. As a result, the Financial Aid Manager of the Cal Grant Operations Branch authorized the request.</p> <ul style="list-style-type: none"> ▪ In the fourth and fifth instances, the amount calculated by Internal Audit did not agree to the amount advanced by CSAC. Based on Internal Audit's calculations, CSAC should have advanced an additional \$490 and \$735, respectively, to two institutions. Cal Grant Operations Branch staff could not account for the difference and agree that the amounts calculated by Internal Audit represented the actual amount that should have been advanced. However, Internal Audit concluded that the \$1,225 that was not advanced is not a material in comparison to the approximately \$724 million disbursed by the institutions in the 2004-2005 award year. <p align="right"><i>No material exceptions noted.</i></p> |

| Audit Objective | Key Procedures Performed | Results |
|---|--|--|
| | <p>A.2 Using ACL, extracted all records in the Grant Advance Table for the 2003-2004 and 2004-2005 award years where the amount advanced to each institution, as calculated by CSAC, exceeded the amount reported by the institution as disbursed to Cal Grant recipients.</p> <p>A.3 Selected a sample of ten institutions that received an advance payment for the fall term of the 2005-2006 award year. For each institution sampled, reviewed the fall 2004-2005 Payment Activity Report to determine the amount of reconciled payments the institutions reported for that term. Summed the payments from the fall term of the 2004-2005 award year and recalculated the advance amount to ensure that the institution received 95% of that amount for the fall 2005-2006 term advance.</p> | <p>A.2 Internal Audit identified 457 instances where 230 institutions received term advances that exceeded the total amount that the institution reported to CSAC as disbursed to Cal Grant recipients. The excess amounts advanced were offset against future advances and/or supplemental disbursements issued in subsequent terms or refunded to CSAC.</p> <p><i>See Section V. Findings and Recommendations – Finding 1</i></p> <p>A.3 Internal Audit determined that all institutions sampled received the correct advance disbursements during the fall 2005-2006 term.</p> <p><i>No exceptions noted.</i></p> |
| <p>B. Ensure supplemental disbursements are properly calculated.</p> | <p>B.1 Compared the payments reported by the institution during the fall term of the 2005-2006 award year against the amount advanced for that same term to determine if a supplemental payment to the institution was warranted. For those institutions entitled to a supplemental disbursement, Internal Audit verified that the supplemental disbursement was equal to the difference between the amounts advanced and the amount reported for the fall term of the 2005-2006 award year.</p> | <p>B.1 Based upon the disbursements to Cal Grant recipients, as reported by the institutions, Internal Audit determined that all schools that were entitled to receive a supplemental payment during the fall term of the 2005-2006 award year received the correct amount.</p> <p><i>No exceptions noted.</i></p> |

| Audit Objective | Key Procedures Performed | Results |
|--|---|--|
| <p>C. Evaluate compliance with the timeframes defined in the Institution Participation Agreement for school reporting of payments and adjustments.</p> | <p>C.1 Using ACL, selected all records from the Grant Payment Extract file, for the 2003-2004 and 2004-2005 award years (using data through the end of November 2005 which was the latest data available at the time of Internal Audit’s test work) where the payment status date was subsequent to the October 15 reporting deadline defined in the Institution Participation Agreement (IPA).</p> <p>C.2 Using ACL, selected all records from the Grant Payment Extract file, for the 2003-2004 and 2004-2005 award years (using data through the end of November 2005 which was the latest data available at the time of Internal Audit’s test work) where the adjustment date was subsequent to the October 15 reporting deadline defined in the Institution Participation Agreement (IPA).</p> | <p>C.1 Internal Audit determined that out of the 554,390 disbursements to Cal Grant recipients reported by institutions in the 2003-2004 award year, 8,581 were reported after the October 15 deadline. For the 2004-2005 award year, 8,910 of the 610,592 disbursements were reported after the October 15 deadline.</p> <p>Based on the combined number of disbursements reported during the 2003-2004 and 2004-2005 award years, Internal Audit noted that 269 out of 373 institutions (or 72%) reported payment transactions after the October 15th deadline in one or both award years.</p> <p><i>See Section V. Findings and Recommendations – Finding 2</i></p> <p>C.2 Internal Audit determined that there were approximately 234,000 adjustments made by institutions during the period reviewed (approximately 111,000 related to the 2003-2004 award year and 123,000 related to the 2004-2005 award year). Further, Internal Audit determined that 7,082 out of the 111,000 adjustments were reported after the October 15 deadline for the 2003-2004 award year. For the 2004-2005 award year, 6,272 of the 123,000 adjustments were reported after the October 15 deadline.</p> <p>Based on the combined number of adjustments reported during the last two award years, Internal Audit noted that, of the 373 institutions that made adjustments during one or both award years, 260 (or 70%) reported such activity after the October 15th reporting deadline.</p> |

| Audit Objective | Key Procedures Performed | Results |
|--|--|---|
| | | <p align="center"><i>See Section V. Findings and Recommendations – Finding 2</i></p> |
| <p>D. Validate that disbursements made by CSAC to institutions are properly posted to CALSTARS.</p> | <p>Selected a sample of 40 claim schedules processed during fiscal year 2003-2004 and 2004-2005.</p> <p>D.1 Verified that the amount reported on the claim schedule was posted to the CALSTARS Grant Streamlining account.</p> <p>D.2 Reviewed the process in which funds are reversed from the CALSTARS Grant Streamlining account and posted into the proper Cal Grant fund account. Selected the month of October 2005 and verified that amounts were properly reversed from the Grant Streamlining Account and applied to the appropriate fund account.</p> | <p>D.1 Internal Audit reviewed 40 claim schedules and found that all the payments were properly posted to the CALSTARS Grant Streamlining account.</p> <p align="center"><i>No exceptions noted.</i></p> <p>D.2 Internal Audit noted that funds were properly reversed from the Grant Streamlining account and applied to the proper Cal Grant fund account.</p> <p align="center"><i>No exceptions noted.</i></p> |
| <p>E. Ensure that Cal Grant funds not disbursed by institutions for a specific award year are returned to CSAC in a timely manner.</p> <p>Evaluate the procedures for collecting amounts owed from institutions for compliance with statutory requirements.</p> | <p>Obtained the GDS payment records and a list of schools which were issued invoices for the 2003-2004 award year from Cal Grant Operations staff.</p> <p>E.1 Using ACL, recalculated the invoice amounts for the 2003-2004 award year by performing the following:</p> <ul style="list-style-type: none"> ▪ Summarized all the advances and supplemental payments by institution from the Grant Advance table. ▪ Summarized all the disbursements to Cal Grant recipients by institution from the Grant Payment Extract. ▪ Summarized all the refunded advance amounts by institution | <p>E.1 Based on Internal Audit’s calculations, 139 of the approximately 370 institutions tested owed funds to CSAC and should have been issued invoices. CSAC issued invoices to all 139 of these institutions. Internal Audit, however, determined that one invoice was issued for \$581, however GDS indicates the amount invoiced should have been \$2,093. CSAC Management represented that the correct amount was invoiced and the difference is the result of an keying error of \$1,512 that occurred in an award year which is now closed, and therefore</p> |

| Audit Objective | Key Procedures Performed | Results |
|---|---|--|
| | <p>from Grant Advance table.</p> <ul style="list-style-type: none"> ▪ Subtracted the disbursements to Cal Grant recipients reported by the schools from the advances and supplemental payments made to institutions, less any payment amounts returned by the institution during the period. <p>E.2 For each institution issued an invoice, reviewed the payment file to determine if the institution remitted the invoice amount in a timely manner.</p> <p>E.3 Reviewed the follow-up procedures performed by CSAC staff to collect amounts owed from the institutions for compliance with the practices defined in SAM.</p> | <p>cannot be corrected in GDS. The correct amount was invoiced and paid.</p> <p><i>No material exceptions noted.</i></p> <p>E.2 Internal Audit noted that 116 of the 139 institutions invoiced at the conclusion of the 2003-2004 award year paid the balance owed within 60 days of being invoiced. Seven institutions invoiced, for a total of \$102,000, had not repaid the amounts due by December 2005. Additionally, as part of this review Internal Audit noted that there were 30 institutions that had outstanding balances totaling approximately \$187,000 from previous award years. Some of the outstanding balances date back as far as 1995.</p> <p><i>See Section V. Findings and Recommendations – Finding 6</i></p> <p>E.3 Internal Audit noted that the Cal Grant Operations Branch merely calls those institutions that have delinquent invoice amounts. CSAC current practice to follow-up on schools with delinquent invoice amounts does not meet the criteria outlined in SAM.</p> <p><i>See Section V. Findings and Recommendations – Finding 6</i></p> |
| <p>F. Verify that refunds received from institutions are accurately reflected in</p> | <p>Obtained a list of refunds from schools for the 2004-2005 award year from Cal Grant Operations staff. Selected a sample of 20 refunds.</p> | |

| Audit Objective | Key Procedures Performed | Results |
|--|---|--|
| <p>CALSTARS and GDS.</p> | <p>F.1 Traced each refund to the GDS Grant Advance Table to ensure that the appropriate institution and student record had been updated accurately to reflect the refund.</p> <p>F.2 Traced each refund to CALSTARS to ensure that the refund was accurately recorded in the accounting system.</p> | <p>F.1 Internal Audit found that only four of the 20 refunds sampled were recorded in the GDS Grant Advance Table. According to Cal Grant Operations Branch staff, GDS only accepts refund transactions if the system reflects an amount owed from the institution at the time the credit is posted. Also it was noted that by system design, once the award year is closed, refunds or payments and adjustments from institutions cannot be posted to GDS.</p> <p><i>See Section V. Findings and Recommendations – Findings 4</i></p> <p>Additionally, while performing the key procedures, Internal Audit noted that occasionally refunds related to audit findings are received by the Program Review Branch from institutions. This practice, which is not consistent with CSAC procedures that require all receipts to be sent to the Fiscal and Administrative Branch, increases the likelihood of refunds being lost or misappropriated.</p> <p><i>See Section V. Findings and Recommendations – Findings 5</i></p> <p>F.2 All refunds tested were accurately applied to CALSTARS.</p> <p><i>No exceptions noted.</i></p> |
| <p>G. Validate that interest earned on Cal Grant funds not yet disbursed by the institutions is remitted to CSAC.</p> | <p>G.1 Requested documentation supporting the efforts performed by CSAC staff to ensure interest owed from the institutions is collected.</p> | <p>G.1 CSAC represented to Internal Audit that there are no procedures currently performed by Cal Grant Operations staff to help ensure that institutions are remitting interest earned on Cal Grant funds deposited in interest bearing accounts. As a result, only 40 institutions out of the 370 that</p> |

Disbursement and Reconciliation Review

| Audit Objective | Key Procedures Performed | Results |
|------------------------|---------------------------------|---|
| | | <p>received Cal Grant funds remitted interest payments, totaling \$175,298 from January 1, 2004 through December 31, 2004. Internal Audit recognizes that the Program Compliance Branch staff perform procedures during their field audits to determine if institutions are remitting interest income for Cal Grant funds to CSAC. However, fewer than 50 institutions are reviewed each year.</p> <p>Additionally, Internal Audit noted that for those interest payments received from the institutions, no mechanism exists in GDS to record interest payments.</p> <p><i>See Section V. Findings and Recommendations – Finding 3</i></p> |

Source: Internal Audit Department, October – December 2005

V. Findings, Recommendations and Management's Responses

Internal Audit's findings and recommendations along with management's responses resulting from this review are provided below.

Finding #1 – The current practice of disbursing funds does not effectively manage the state's cash flow resulting in excess funds being disbursed to and held by institutions.

The California Education Code section 69432.8 makes provisions for CSAC to advance funds to institutions. CSAC's current practice, in place for more than ten years, is to advance to an institution 95% of the amount that was disbursed to Cal Grant recipients by the institution for the same term in the previous academic year. For example if an institution reported disbursements for the fall term of the 2002-2003 award year of \$100,000, they would receive a 2003-2004 fall term advance of \$95,000 (\$100,000 x 95%).

For the 2003-2004 and 2004-2005 award years, Internal Audit identified 457 instances where 230 institutions received term advances that exceeded the total amount that the institution reported to CSAC as disbursed to Cal Grant recipients. The excess amounts advanced for these 457 instances were offset against the advances and/or supplemental disbursements issued in subsequent terms or were later refunded to CSAC.

The Cal Grant Manual states that in the January, following the close of the award year, institutions that owe funds back to the State as a result of the final reconciliation will be sent an invoice. However, at any time during the award year when a school identifies that excess funds were received through advances and supplemental payments, those funds can be returned to CSAC. Internal Audit determined that in the 2003-2004 award year, institutions owed approximately \$5.8 million to CSAC. Of the \$5.8 million, \$1.96 million was refunded by institutions prior to the close of the award year before CSAC's invoicing process occurred and \$3.87 million was invoiced by CSAC in January 2005. Similarly, for the 2004-2005 award year, institutions owed approximately \$5.4 million to CSAC, of which \$2.7 million was refunded by institutions prior to the close of the award year before CSAC's invoicing process occurred and \$2.7 million was invoiced by CSAC in January 2006. The current methodology for issuing advances and supplemental disbursements allows schools to maintain state funds in excess of those needed for disbursements to Cal Grant recipients for several months. In one of the instances identified by Internal Audit for example, an institution was advanced \$99,375 for the fall term in August 2004 and did not report any student payments for that award year. The school, however, did refund that amount in April 2005. As a result, the institution had the use of \$99,375 for eight months before it was returned to CSAC.

Recommendation #1 - Reassess the current methodology of issuing advances and supplemental disbursements to institutions in an effort to improve cash flow for the State.

CSAC should reevaluate the current methodology for issuing advances and supplemental disbursements to determine the best way to effectively manage the State's cash flow and reduce the excess funds being disbursed to institutions. Consideration should be given to the following methods:

- Calculate term advances to institutions based on final reconciled amounts disbursed to Cal Grant recipients. The current process for calculating term advances for those terms that begin before the previous award year is finalized rely on disbursements reported by institutions that are still subject to adjustment by the institution. For example, the fall term advance for the 2005-2006 award year, disbursed in August 2005, is computed based on the amounts disbursed and reported for the fall 2004 term. It should be noted that amounts reported as disbursed for the fall 2004 term were not finalized and, therefore, were subject to additional reporting and/or adjustments until the final reconciliation was performed in December 2005.
- Reduce the current 95% advance to institutions to a lower percentage.
- Advance only those funds to institutions needed for non-tuition disbursements that are paid directly to Cal Grant recipients such as for books, supplies, and other expenses. CSAC should issue a payment for the tuition and fees, which are generally credited to the Cal Grant recipient's account at the school, upon notification from the institution that the disbursement has been made. Based on data from the 2003-2004 and 2004-2005 award year, the amount advanced to institutions could have been reduced by as much as 70%.
- Eliminate advances to institutions all together and instead only make payments based on actual costs incurred as reported by the institutions. The current technology in use, including on-line reporting and funds delivery through electronic fund transfers (EFT), allows for a fairly short turnaround time to deliver funds to institutions.

Management's Response to Recommendation 1 – CSAC Management agrees a reevaluation of the advance and supplemental advance process is appropriate given the increase in program participants and funding over the last 10 years. Since March 2005, CSAC Management has been meeting to discuss the development of new policies regarding the advance process and is seriously considering all the options detailed in the Audit Report and others provided by CSAC staff. CSAC staff intends to present their recommendations for implementing the audit findings to the Commission at regularly scheduled Commission meetings during the 2006 calendar year.

Finding #2 - The timeframes in which institutions report disbursements and adjustments to CSAC often exceed the date defined in the Institution Participation Agreement (IPA), creating cash flow issues and impacting CSAC's ability to effectively forecast future cash flow needs.

The Institution Participation Agreement (IPA) between the schools and CSAC states that it is the institutions' responsibility to reconcile all Cal Grant funds received and disbursed to students by no later than the October 15th following the end of the award year. This timeframe allows the institutions up to approximately 10 months to finalize their reporting of fall term activity (assuming that the fall term ends in mid December), which creates cash flow issues. Furthermore, the Cal Grant Manual, a procedures manual developed by CSAC staff to assist schools' in administering the Cal Grant

Program, states that institutions may continue to resolve any outstanding payment issues and report payments and adjustments to CSAC during the months of October and November. Thus, there is an inconsistency between the reporting deadlines between the IPA and the Cal Grant Manual.

A high volume of adjustments are made by schools to the Grant Delivery System. For the last two award years combined there were approximately 234,000 adjustments recorded in GDS. Approximately 102,000 of these adjustments were the result of changes in student enrollment status from full-time to part-time. Approximately 50,000 adjustments were the result of eligible Cal Grant recipients opting to defer their award for use at a later time. Additionally, over 38,000 adjustments were made to reduce the award amount when the actual cost of a program was less than the Cal Grant amount awarded.

Through an analysis of data extracted from GDS for the 2003-2004 and most of the 2004-2005 award years (based on the date of Internal Audit's test work), Internal Audit noted that 17,491 disbursements were reported and 13,354 adjustments made by institutions after the October 15th reporting deadline for both award years combined. Based on Internal Audit's test work, 269 of the 373 institutions (or 72%) that reported payments and/or made adjustments during one or both award years reported such activity after the October 15th reporting deadline. For example, upon review of the December 16, 2005 Payment Activity Report for the 2004-2005 award year, Internal Audit noted that one institution reported an additional \$33,713 in student payments in December 2005 for the 2004 fall term, approximately 12 months after the term ended. Additionally, another institution reported \$93,698 in adjustments in November 2005 for the 2004 fall term, approximately 11 months after the term ended.

Internal Audit also noted several instances where institutions reported payments to CSAC before they actually disbursed the funds to Cal Grant recipients. Currently, an institution can report a full time student disbursement in August for the spring term when they may actually not disburse the funds to the student until the spring term begins the following January or possibly not at all should the student transfer to another school. Although the transaction is suspended in GDS and not processed until after the spring advance is issued, the fact that the institution reported the payment often results in an adjustment, because the institution has no way of knowing the actual amount of the disbursement that they will eventually make to a student.

The lack of timely reporting of payments by the institution, in conjunction with the large number of adjustments that occur well beyond the end of the term to which they apply, makes the task of effectively forecasting cash flow needs extremely difficult for CSAC staff.

Recommendation #2 - Require institutions to report disbursements and make adjustments prior to the published reporting deadline for each award year. Also, consider implementing additional reporting deadlines at the conclusion of each term.

CSAC should develop and implement procedures limiting institutions from reporting payments more than 30 days prior to the beginning of a term. Additionally, the institutions should be required to perform the final reconciliation of disbursements to Cal Grant recipients within 30-60 days of the end of each term. GDS should also be modified to limit an institution's ability to report payments or make adjustments beyond 30-60 days subsequent to the end of the term. This would require institutions to report disbursements and adjustments in a more timely manner and allow CSAC to offset remaining funds already paid to the institutions when making subsequent term advances and supplemental

payments. However, CSAC staff should still have the ability to make adjustments in GDS beyond the time period which the schools are permitted in order to resolve any extra ordinary situations reported by the institutions. Implementation of this recommendation should curtail the large number of adjustments made in GDS, and therefore reduce the need to invoice institutions at the conclusion of the award year.

Management's Response to Recommendation 2 – CSAC Management concurs that a reassessment of payment reporting deadlines is in order. To this end, CSAC management and staff have been meeting approximately every two weeks since November 2005 to consider all available options with regard to the disbursement process. The recommendations given in the Audit report have already been incorporated into a staff proposal for enhancing the disbursement process as possible alternatives to the current disbursement process. CSAC staff intends to present their recommendations for implementing the audit findings to the Commission at regularly scheduled Commission meetings during the 2006 calendar year.

Finding #3 - There is no mechanism in place to ensure the collection, tracking and reporting of interest earned on Cal Grant funds by institutions.

Internal Audit found that CSAC does not have procedures for institutions to report interest payments, nor do they know which institutions owe interest. For those institutions that are remitting interest, CSAC does not have a method to track interest payments received. The Institutional Participation Agreement (IPA) requires schools to remit any interest earned from Cal Grant funds deposited in interest earning accounts. However, CSAC does not have any procedures or processes in place to ensure that schools are remitting such interest. CSAC's Program Compliance Branch performs procedures during their field audits to determine if institutions are remitting interest income from Cal Grant funds to CSAC. However, given Program Compliance's limited resources, only 50 of the approximately 370 institutions are reviewed each year. Of the 52 institutions reviewed during fiscal year 2004-2005, the branch auditors found that 10 of the schools failed to remit interest earned.

Internal Audit determined that only 40 institutions (virtually all of which were public schools), out of the 370 that received Cal Grant funds, remitted interest payments of \$175,298 from July 1, 2004 through June 30, 2005. However, in the 2004-2005 award year, CSAC disbursed approximately \$724 million to institutions through advances and supplemental payments. According to the State Administrative Manual Section 8099, the State earns approximately \$27 on each million dollars per calendar day for each 1% of interest earning rate. For instance, interest of \$39,096 would be earned on \$724 million at 2% of interest in one day. In the 2004-2005 award year, CSAC disbursed approximately \$264 million for the fall 2004 advance on August 9th, roughly two weeks prior to the beginning of the fall term for most institutions. For illustration purposes, assuming all schools deposited the advance into an interest bearing account, interest earnings on the fall advance for those 14 days alone would have totaled approximately \$199,584, exceeding the amount of interest CSAC recognized for the entire 2004-2005 award year (assuming an interest rate of 2% and no payments were made to Cal Grant recipients during this period).

Recommendation #3 - Require institutions to maintain Cal Grant funds in an interest bearing account. Additionally, modify the Grant Delivery System (GDS) to track interest remitted by institutions and develop formal procedures to ensure schools are remitting interest earned on Cal Grant funds.

In order for the Cal Grant Operation Branch staff to know which institutions owe interest to CSAC and to ensure interest payments are received from institution, the branch should:

- Establish procedures for institutions to report interest payments.
- As a part of the Institution Participation Agreement (IPA), require institutions to maintain Cal Grant funds in an interest bearing account.
- Modify GDS and create a field to record interest remitted by institutions.
- Establish procedures to at least annually ensure schools are remitting interest income. For example, require institutions to submit an Internal Revenue Service Form 1099 reporting interest earned annually (assuming the school maintains the funds in a separate bank account). Alternatively, in addition to the institutions being reviewed by the Program Compliance Branch, Cal Grant Operations staff should select a sample of institutions and, based on the payments advanced, perform tests to determine the reasonableness of the interest amounts that should be received.

Management's Response to Recommendation 3 – CSAC Management recognizes the fiscal advantage to the General Fund of requiring participating schools to maintain their Cal Grant funds in an interest bearing account. CSAC Management also recognizes this proposal will increase the workload at both CSAC and institutional levels. This recommendation will be given serious consideration by CSAC Management, as are the costs associated with modifying GDS and the increased workload. CSAC staff intends to present their recommendations for implementing the audit findings to the Commission at regularly scheduled Commission meetings during the 2006 calendar year.

Finding #4 - Refunds received from schools can not always be recorded in GDS.

Internal Audit reviewed 20 refunds received from institutions from January 1, 2004 through December 31, 2005 and found that, although all the refunds were properly reported in CALSTARS, only four were recorded in GDS. The Cal Grant Operations Branch staff represented that GDS only accepts refund transactions if the system reflects an amount owed from the institution at the time the credit is posted. Additionally, it was noted that by system design, once the award year is closed, refunds or payments and adjustments from institutions cannot be posted to GDS. Therefore, refund amounts returned to the State for a prior year are currently not recorded in GDS. Furthermore, without having all refund transactions recorded in GDS, CSAC cannot reconcile CALSTARS with GDS.

Recommendation #4 - Modify GDS to allow the recording of refunds from institutions related to a closed award year. Develop formal procedures to require that refunds recorded in CALSTARS (the State's accounting system) be reconciled to GDS and any differences resolved.

The Cal Grant Operations Branch should request that GDS be modified to allow all refund payments to be recorded in the system to properly account for Cal Grant funds. The Fiscal and Administrative Services Branch should ensure that all Cal Grant refunds are posted to both CALSTARS and GDS. Additionally, the summary level detail of Cal Grants maintained in CALSTARS should be periodically reconciled to the student detail in GDS to ensure all transactions are properly recorded and accounted for.

Management's Response to Recommendation 4 – CSAC Management recognizes the need for CALSTARS to reconcile with GDS and agrees to begin a study of the costs associated with modifying GDS to accept closed year refunds and manual payments. CSAC staff intends to present their recommendations for implementing the audit findings to the Commission at regularly scheduled Commission meetings during the 2006 calendar year.

Finding #5 - Refunds are not consistently handled in accordance with established procedures.

The Fiscal and Administrative Branch's established procedure for receiving cash receipts requires that all checks remitted to CSAC be sent to the branch's post office box. The mail room delivers the mail to the branch and checks are opened and recorded immediately in a controlled environment by various independent staff to help ensure that no checks are lost or misappropriated. While performing test work on refunds, Internal Audit noted that occasionally refund checks related to audit findings are received by the Program Compliance Branch from the institutions. Specifically, Internal Audit determined that during fiscal year 2004-2005, \$731,870 in refund checks remitted from institutions as a result of Program Compliance audit findings, were sent directly to the Program Compliance Branch P.O. Box or address in order for Program Compliance staff to document the receipt of the check and clear their audit findings. These checks were opened by the Program Compliance Branch staff outside of the controlled environment and then hand carried across the street to the Fiscal and Administrative Branch. This process does not follow the procedures that the Fiscal and Administrative Branch established to help prevent the loss or misappropriation of funds.

Recommendation #5 - Document and reinforce established procedures to require institutions to remit all payments directly to the Fiscal and Administrative Branch. Currently, institutions occasionally send payments related to audit findings to the Program Compliance Branch.

All funds remitted to CSAC should be sent directly to the post office box established for the Fiscal and Administrative Branch and processed through the established cash receipt process. Moreover, the Program Compliance Branch should cease its practice of allowing remittance checks to be sent directly to their post office box or address. The Fiscal and Administrative Branch should notify the Program Compliance Branch when funds related to audit findings are received so that these findings can be cleared.

Management's Response to Recommendation 5 – The Commission's Program Compliance Branch within the Management Services Division has established procedures to require institutions to remit all payments directly to the Accounting Office.

Finding #6 - CSAC lacks procedures, as required by the State Administrative Manual (SAM), to collect amounts owed from institutions.

Every January, CSAC produces and sends out invoices to those institutions in possession of undisbursed Cal Grant funds for the award year that ended the preceding June. Occasionally, staff may call the institutions in an attempt to collect the amounts owed. CSAC, however, does not have formal procedures established for following up with those institutions who fail to remit the invoiced amount in a timely fashion. SAM requires State departments to develop collection procedures that will ensure prompt follow-up on receivables. Specifically, the accounting office should send a sequence of three collection letters at 30 day intervals. If a reply or payment is not received within 30 days, a subsequent letter should be sent referencing the previous letter and requesting repayment in a stronger tone and stating the possible consequences.

As of January 2005, the last time invoices were generated prior to Internal Audit's test work, thirty institutions who owed funds from previous years, going back as far as 1995, were invoiced nearly \$187,000 and have not yet remitted the amounts owed. Moreover, management represented to Internal Audit that four of these institutions are no longer in business. Institutions are reinviced for all outstanding amounts at the close of each award year, however, CSAC does not perform any other efforts during the year to actively follow-up on outstanding amounts. According to SAM, CSAC can not request discharge or write off uncollectible amounts due without first attempting reasonable collection procedures.

Recommendation #6 – Implement invoicing and follow-up procedures for collecting amounts owed to CSAC that are consistent with the guidelines defined in the State Administrative Manual (SAM).

The Cal Grant Operations Branch and the Fiscal and Administrative Services Branch should implement its invoicing procedures consistent with those defined in SAM.

Internal Audit recognizes that CSAC staff is currently developing and implementing new invoicing procedures. CSAC staff anticipates that these changes, along with other related proposals, will be forwarded to the Commission for its consideration in February and April 2006. The approval and implementation of these procedures should make CSAC compliant with SAM. Furthermore, CSAC would be able to write off those amounts owed by schools that are no longer in business or deemed uncollectible.

Management's Response to Recommendation 6 – CSAC Management agrees with the recommendation. Newly developed, short-term procedures have been implemented to improve the invoicing process. These short-term procedures include a revised cover letter detailing the institutions responsibilities and mailing a copy of the invoice and cover letter to the fiscal office as well as the financial aid office.

Long- term procedures and strategies have also been developed to ensure complete compliance with SAM and improve the collection process. CSAC staff intends to present long-term procedures to the Commission at regularly scheduled Commission meetings during the 2006 calendar year.

VI. Implementation Plan for Recommended Actions

Exhibit 3 below presents Internal Audit’s recommended actions resulting from this review. The assigned individuals responsible for ensuring that the actions are implemented are also included.

Exhibit 3: Recommended Actions

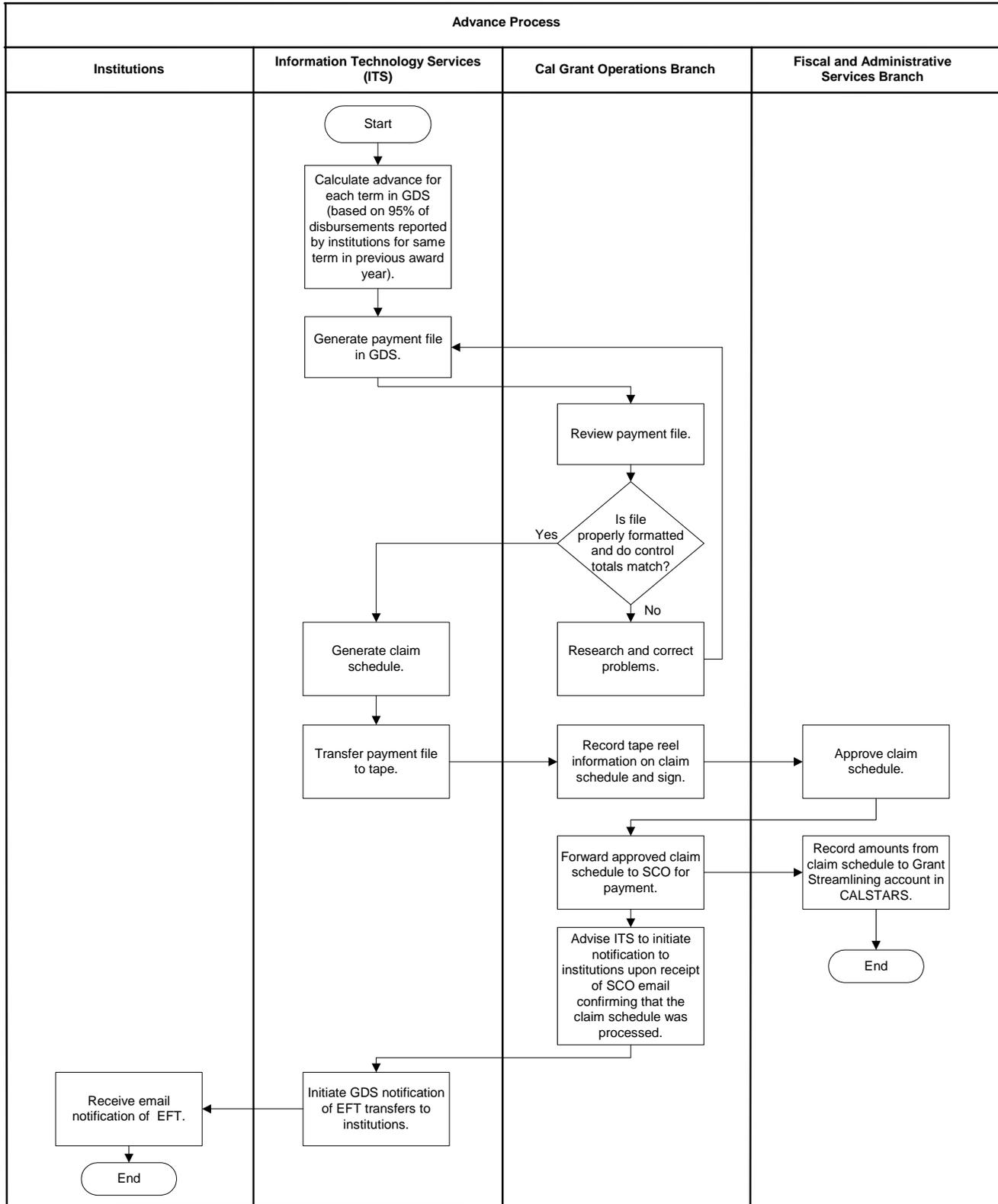
| Recommended Actions | Assigned Lead |
|--|--|
| <i>1. Reassess the current methodology of issuing advances and supplemental disbursements to institutions in an effort to improve cash flow for the State.</i> | Chief, Program Administration and Services Division and Chief, Management Services Division |
| <i>2. Require institutions to report disbursements and make adjustments prior to the published deadline for each award year. Also, consider implementing additional reporting deadlines at the conclusion of each term.</i> | Manager, Cal Grant Operations Branch and Manager, ITS Project Management Branch |
| <i>3. Require institutions to maintain Cal Grant funds in an interest bearing account. Additionally, modify the Grant Delivery System (GDS) to track interest remitted by institutions and develop formal procedures to ensure schools are remitting interest earned on Cal Grant funds.</i> | Manager, Cal Grant Operations Branch and Manager, ITS Project Management Branch |
| <i>4. Modify GDS to allow the recording of refunds from institutions related to a closed award year. Develop formal procedures to require that refunds recorded in CALSTARS (the state’s accounting system) be reconciled to GDS and any differences resolved.</i> | Manager, Cal Grant Operations Branch, Manager, ITS Project Management Branch, and Manager, Fiscal and Administrative Services Branch |
| <i>5. Document and reinforce established procedures to require institutions to remit all payments directly to the Fiscal and Administrative Branch. Currently, institutions occasionally send payments related to audit findings to the Program Compliance Branch.</i> | Chief, Management Services Division |
| <i>6. Implement invoicing and follow-up procedures for collecting amounts owed to CSAC that are consistent with the guidelines defined in the State Administrative Manual (SAM).</i> | Manager, Cal Grant Operations Branch, Manager, ITS Project Management Branch, and Manager, Fiscal and Administrative Services Branch |

Source: Internal Audit Department, October – December, 2005

Internal Audit will meet with the assigned leads reflected in Exhibit 3 during January 2007 to evaluate the implementation and progress of all corrective actions identified as part of this review.

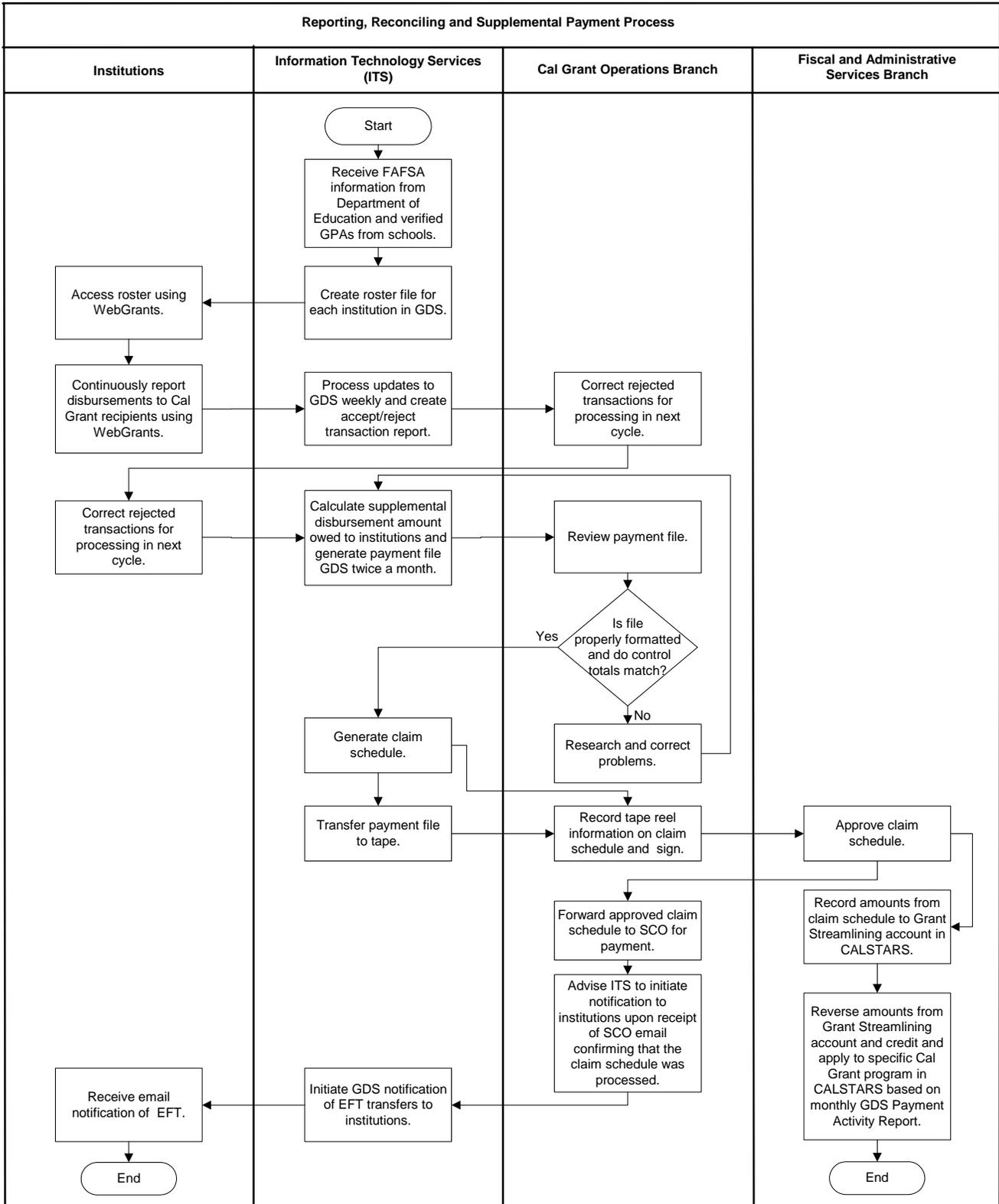
Appendix A

High Level Flowchart of the Disbursement and Reconciliation Processes



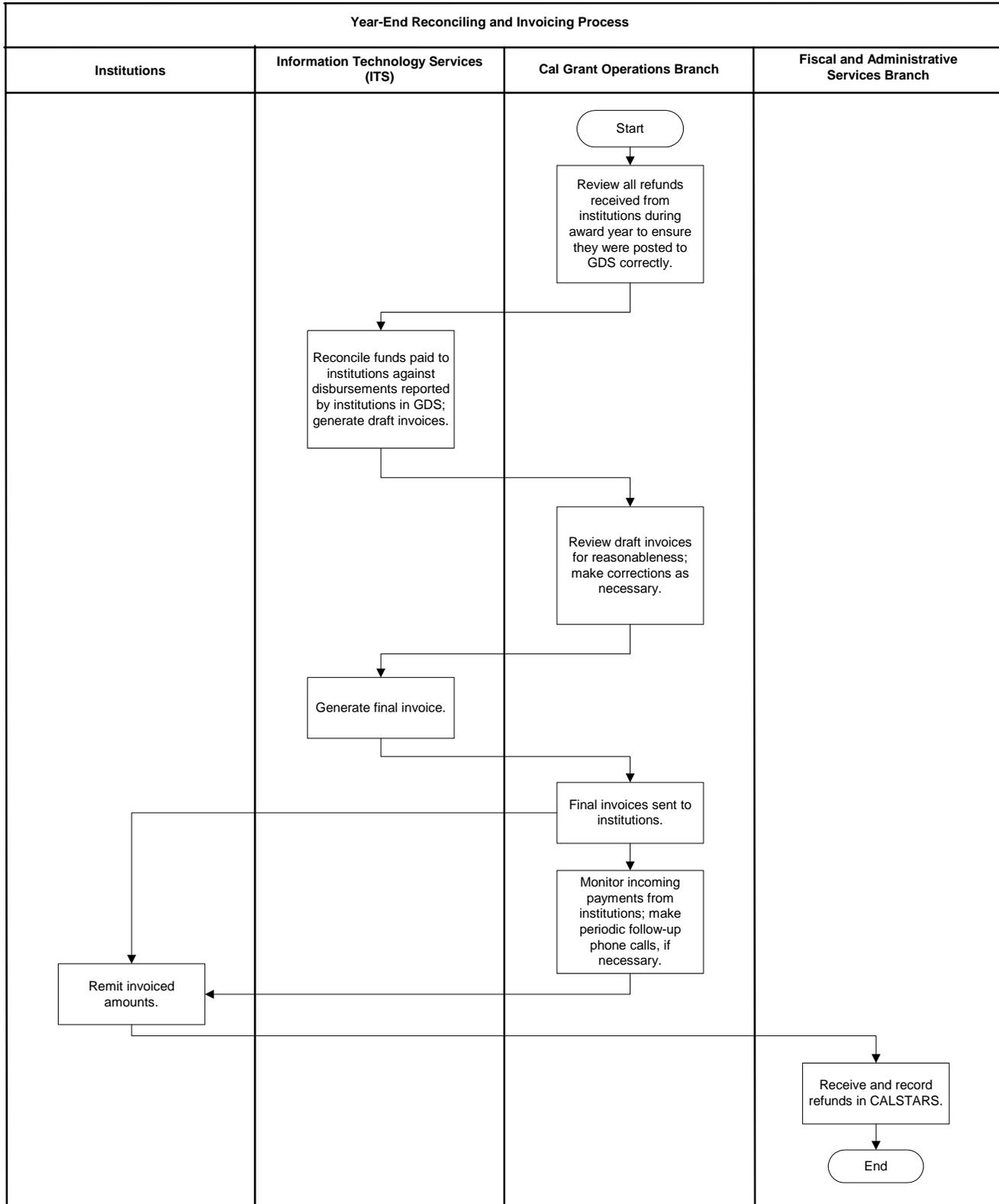
Source: Internal Audit Department, October – December, 2005

High Level Flowchart of the Disbursement and Reconciliation Processes



Source: Internal Audit Department, October – December, 2005

High Level Flowchart of the Disbursement and Reconciliation Processes



Source: Internal Audit Department, October – December, 2005

Appendix B

CALIFORNIA STUDENT AID COMMISSION
CAL GRANT PROGRAMS

Institutional Participation Agreement
For New Postsecondary Institutions

Name of Institution: _____

Address of Institution: _____

USED School Identification Number: _____

Return to:
California Student Aid Commission
Program Administration & Services Division
ATTN: School Support Services
PO Box 419028
Rancho Cordova, CA 95741-9028

Execution of this Agreement is mandatory for participation in the California Student Aid Commission's Cal Grant Programs.

INTRODUCTION

- A. The minimum requirements for participation in the Cal Grant Programs for postsecondary institutions in California are established in California Education Code (CEC) 69432.7(l) and the California Code of Regulations (CCR) Title 5, Section 30009.
- (1) For non-public postsecondary institutions to participate in the Cal Grant Programs, an institution must be approved by the United States Department of Education (USED) to participate in the Federal Pell Grant program and two of the three federal campus-based student aid programs. The campus-based programs include Federal Work-Study, Federal Perkins Loan and the Federal Supplemental Educational Opportunity Grant (SEOG) programs [CEC 69432.7(l)(1)]. Specifically, participation in the campus-based programs means the postsecondary institution has been allocated funds and is spending those funds at each campus/site/branch ("campus") that Cal Grant recipients attend. These program requirements are set forth in CCR 30009(b).
 - (2) For non-public postsecondary institutions, California law allows an exception to the requirement of participation in the federal student aid programs. Cal Grant awards may be utilized at any nonprofit institution headquartered and operating in California that: (a) certifies to the Commission that ten (10) percent of the institution's operating budget, as demonstrated in an audited financial statement, is expended for the purposes of institutionally funded student financial aid in the form of grants, (b) demonstrates to the Commission that it has the administrative capability to administer the funds, and (c) is accredited by the Western Association of Schools and Colleges [CEC 69432.7(l)(2) and CCR 30009 (c)].
 - (3) A California public postsecondary educational institution or program may participate in the Cal Grant Programs [CEC 69432.7(l)(3)].
- B. Commencing with the 2001-02 academic year and each academic year thereafter, Cal Grant T awards shall be used only for tuition and student fees for a maximum of one academic year of full-time attendance in a program of professional preparation that has been approved by the California Commission on Teacher Credentialing [CEC 69440(a)].
- C. An otherwise qualifying institution shall be deemed disqualified if it no longer possesses all of the requirements for a qualifying institution [CCR 30009(d)].
- D. If a shift in control or change of ownership of an institution occurs, the Agreement expires and the institution's Cal Grant participation ends on the date of the shift in control or change of ownership. If the new controlling party or new owner wishes to continue Cal Grant participation, a new Agreement must be completed.
- E. This Agreement covers only campus(es) indicated on this Agreement. A new Agreement is required for any additional campus.
- F. As used in this Agreement, "academic year" and "award year" mean July 1 to June 30 as defined in CEC 69432.7.

ARTICLE I

Participation

The Commission and _____ hereafter referred to as the "Institution" agree to the terms contained in this Agreement.

This Agreement governs the Institution's eligibility to participate in and ability to receive funds for all of the Cal Grant Programs administered by the Commission.

ARTICLE II

General Provisions

- A. The Institution agrees to use Cal Grant funds provided to it solely for the purposes specified, and in accordance with the provisions set forth in the respective program statutes, federal and state regulations and procedures, the California Grant Programs Manual including manual updates, policy bulletins, operations memos, and special alerts.
- B. The Institution acknowledges that no Cal Grant funds have been authorized for a fiscal year until such time as that fiscal year's budget has been adopted by the Legislature and signed by the Governor. It is further understood that if such funds are not approved for a fiscal year, the State and the Commission shall be relieved of further payments and this Agreement will be canceled; if proposed funding amounts are reduced, this Agreement will be limited to the approved amounts only.
- C. The Institution agrees to maintain standards of administrative capability and financial stability in accordance with state and federal law and regulations as applicable. The Institution shall maintain documentation that allows the Commission to determine its adherence to fiscal responsibility and standards.
- D. The Institution agrees to establish written policies and procedures that provide security and confidentiality of all recipients' personal identification information, payments, financial history and other related confidential information and documents as required under state and federal law and regulations.
- E. When the Institution participates through the Commission's electronic system, the Institution agrees to comply with the Information Security and Confidentiality Agreement.
- F. The Institution agrees to maintain a current designation of individuals who are responsible for coordinating and communicating with the Commission on matters related to the provisions of this Agreement.
- G. The Institution shall maintain written policies and procedures governing the administration and processing of Cal Grant funds under this Agreement.
- H. The Institution agrees to retain comprehensive and accurate program and fiscal records that demonstrate institutional and student eligibility that fully documents the accuracy of the grant payments reported and the right of the Institution to receive or retain payments made by the Commission for a period of three (3) years following the last day of the period for which the grant was intended.

- I. The Institution agrees to make available at the time of program compliance review, or at the request of the Commission, any records and personnel related to the administration of the Commission's Cal Grant Programs.
- J. The Institution agrees that it is subject to and must comply with all current and applicable state and federal law and regulations in its enforcement of the terms of this Agreement. The Institution agrees that noncompliance with any of these provisions may result in the termination of this Agreement and the privileges that are afforded under it. The Commission shall provide the Institution written notice of its intent to terminate the Agreement ten (10) days prior to such action.

ARTICLE III

Cal Grant Account Maintenance – Institutional Responsibilities

- A. The Institution agrees to maintain all Commission Cal Grant funds in a designated account identified as the property of the State either by a ledger account or a bank account.
 - 1) The Institution may deposit funds from various sources including Cal Grant funds into one bank account, but must identify the Cal Grant funds by using subsidiary ledgers. All activity (deposits and expenditures) of Cal Grant funds must be supported by appropriate accounting records in accordance with generally accepted accounting principles and practices.
 - 2) The Institution may establish a separate bank account designated for Cal Grant funds.
 - 3) Interest earned on Cal Grant funds in these accounts must be returned to the Commission on behalf of the State.
- B. Should the Institution close, lose federal financial aid eligibility, or no longer meet the statutory definition of an eligible institution, or upon termination of this Agreement, the Institution agrees to return any undisbursed funds or pay any outstanding invoices within ten (10) days.
- C. The Institution agrees to maintain a current designation of individuals who are responsible for Cal Grant account maintenance and adherence to accepted accounting practices and principles. The Institution also agrees to maintain a separate designation of individuals who authorize and disburse Cal Grant funds so that no one individual is responsible for both functions.

ARTICLE IV

Cal Grant Disbursement - Institutional Responsibilities

The Institution understands and agrees to carry out the following responsibilities at the time Cal Grant funds are transferred to the recipient or to the recipient's account. These must include but are not limited to:

A. Verification of Eligibility: Verify the recipient meets all eligibility and program requirements and resolve any conflicting information before disbursing Cal Grant funds.

B. Confirmation of Eligibility: Confirm and document that students listed on a Commission roster or other award notification meet basic eligibility requirements including California residency, financial need and appropriate program eligibility.

C. Disbursement of Cal Grant Funds:

- 1) Establish a written disbursement policy consistent with the Commission's policies and guidelines.
- 2) Establish a written disbursement schedule consistent with the start dates of the Institution's enrollment periods and in accordance with the applicable requirements specified for each educational program.
- 3) Determine course attendance according to the recipient's attendance status at the time Cal Grant funds are paid. Disburse "Access" and "Books and Supplies" payments within ten (10) days of verification of enrollment status.
- 4) Disburse no more than that which the recipient is eligible to receive per academic term. The Institution must use its institutional refund policy to determine the portion to be returned to the Commission on behalf of the State. Cal Grant funds may not be used for reimbursement to the federal government.
- 5) Regularly submit payment transactions through WebGrants, data files, or the Grant Roster.
- 6) Make all disbursements no later than September 30 following the end of the award year (e.g., September 30, 2003, for award year 2002-03).
- 7) Establish and publish a policy that informs students of their options regarding receipt of Cal Grant funds and their subsequent ability to rescind their existing instructions at any time.

D. Accounting/Reconciliation:

- 1) Maintain an accounting system which conforms to generally accepted accounting principles and practices that includes such items as, but is not limited to, cash receipts and disbursement journals, bank account reconciliation, evidence of receipt of funds by recipients or credit of funds to recipients, and all other accounting records necessary to account for all transactions.
- 2) Reconcile all Cal Grant funds received and disbursed by the Institution no later than October 15 following the award year (e.g., October 15, 2003, for the 2002-03 award year). The Institution must report adjusted payment transactions for payment transactions previously reported in error that result in a payment exceeding the recipient's eligibility.

Upon final reconciliation by the Institution, the Institution shall repay any Cal Grant funds in excess of the reconciled amount to the Commission. Upon final reconciliation by the Commission, the Institution shall be invoiced for excess funds.

The invoice shall be due and payable to the Commission within 30 days of receipt of the invoice. The Institution agrees to resolve any reconciliation discrepancies with the Commission.

- 3) Submit annual College Cost Estimates to the Commission by the deadline specified.
 - 4) Certify the accuracy of all payment transactions submitted to the Commission. Certification of electronic submissions (WebGrants and data files) must be provided through the Information Security and Confidentiality Agreement. Signatures from the financial aid and accounting offices demonstrate certification for paper Grant Rosters.
 - 5) Agree to reconcile Cal Grant program expenditures for each award year on a student-by-student basis. The Institution certifies that it has paid each student an amount that reconciles to the Commission's records for both Cal Grant funds expended and student attendance. An institution may not apply excess Cal Grant funds to any other student's account or to any prior year accounts.
 - 6) Recalculate, if a recipient withdraws, drops out or is expelled for a term for which a payment has been made, based upon the Institution's repayment policy, whether an overpayment has been made to the recipient and whether the recipient owes a repayment to the Commission.
 - 7) Agree to pay any institutional liability that is determined as a result of a program compliance or an audit review within thirty (30) days of the determination or in the time specified in the program review report.
 - 8) Liability to the Commission for the Institution's actions or omissions under this Agreement shall not exceed the actual amount of Cal Grant funds that the Institution is not entitled to retain.
 - 9) Failure by the Institution to take action on Cal Grant funds that the Institution is ineligible to retain may constitute noncompliance and may result in the termination of this Agreement thereby terminating the Institution's participation in the Cal Grant Programs.
- E. The Institution agrees to maintain a current designation of individuals who are responsible for Cal Grant disbursement and adherence to accepted accounting practices and principles. The Institution also agrees to maintain a separate designation of individuals who authorize and disburse Cal Grant funds so that no one individual is responsible for both functions.

ARTICLE V

Cal Grant Program Guidelines - Commission's Responsibilities

- A. Determine new applicants' initial eligibility for Commission-administered grant programs by evaluating their financial information and program specific data as provided on the Free Application for Federal Student Aid (FAFSA), the verified Grade Point Average, and any other selection process.

- B. Provide the Institution with guidelines, information, and ongoing assistance with respect to the Institution's administration of the Cal Grant Programs.
- C. Identify recipients who are in default on any educational loans as indicated by the FAFSA information.
- D. Generate and provide electronic data files and Grant Rosters that include names, Social Security Numbers and payment amounts of eligible recipients to the Institution.
- E. Provide the Institution with instructions for completing payment transactions.
- F. Notify the Institution of accepted and rejected payment transactions.
- G. Reconcile accepted payment transactions.
- H. Provide the State Controller's Office with the documentation needed to issue Electronic Funds Transfer (EFT) or mail warrants for payment to the Institution.
- I. Provide the Institution with regularly updated electronic data and Grant Rosters identifying reconciled payments.
- J. Invoice the Institution for funds due the Commission as a result of the final reconciliation process and notify the Institution if funds will be withheld pending the return of delinquent repayments.
- K. Retain records relative to Commission grants and grant payments for a period of three (3) years following the last day of the award year.
- L. Review and audit the Institution's management of Cal Grant funds for compliance with state and federal law and regulations and Commission policies.

ARTICLE VI

Agreement Duration

This Agreement is effective when it is executed by the Commission's representative. This is generally later than its execution by the Institution's representatives. It supersedes any prior Agreements executed between the Commission and the Institution, and automatically terminates upon the occurrence of any of the conditions below:

- A. The Institution undergoes a change which results in change of ownership or control; or
- B. The Institution closes or ceases operation; or
- C. The Institution or site no longer possesses all of the requirements for a qualifying institution; or
- D. The Commission's representative requests termination of this Agreement in writing; or
- E. The Institution's Chief Executive Officer requests termination of this Agreement in writing; or
- F. June 30, 2007.

ARTICLE VII

Certification

As Chief Executive Officer of this Institution, I agree that this Institution and its “campus(es)” (if any) will comply with all state and federal statutes and regulations, rules, and guidelines applicable under this Agreement.

Name and Address of Main Campus: USED School
Identification Number

Name(s), Address(es), and Phone Number(s) of Branch USED School
Identification Number
Campus(es) included in this Agreement:



Please indicate which of the following section(s) establish your Institution’s eligibility to participate in the Cal Grant Programs. Many institutions’ eligibility is established through Section 69432.7(l)(1) or (3) or 69440(a) of the CEC. If your Institution is seeking to establish eligibility through Section 69432.7(l)(2) of the CEC, please complete the attached “Financial Statement and Demonstration of Administrative Capability to Participate in the Cal Grant Programs” form.

Section 69432.7(l)(1) of the CEC states: “Qualifying institution” means the following:

“Any California private or independent postsecondary educational institution that participates in the Pell Grant program and in at least two of the following federal campus-based student aid programs: (A) Federal Work-Study, (B) Perkins Loan Program, [and] (C) Supplemental Educational Opportunity Grant Program [SEOG].” Participation in the campus-based programs means the Institution or site has applied for, been allocated funds, and is spending those funds. Participation in the Federal Pell Grant program means that students are eligible to be paid Federal Pell Grant funds for attendance at the Institution.

...

Initial if applicable:

_____ I hereby certify that this Institution meets the requirements of Section 69432.7(l)(1) of the CEC.

Section 69432.7(l)(3) of the CEC states:

“Any California public postsecondary educational institution.”

Initial if applicable:

_____ I hereby certify that this Institution meets the requirements of Section 69432.7(l)(3) of the CEC.

Section 69440(a) of the CEC states:

“Commencing with the 2001-02 academic year, and each academic year thereafter, Cal Grant T awards shall be used only for tuition and student fees for a maximum of one academic year of full-time attendance in a program of professional preparation that has been approved by the California Commission on Teacher Credentialing.”

Initial if applicable:

_____ I hereby certify that this Institution meets the requirements of Section 69440(a) of the CEC.

_____ I will immediately notify the Commission if the Institution ceases to be eligible under Sections 69432.7(l)(1) or (3), 69440(a) of the CEC, or Article VI of this Agreement.

Additional requirements:

Section 66290 of the CEC states:

“Prior to receipt of any state financial assistance or state student financial aid, a postsecondary educational institution shall provide assurance to the agency administering the funds, in the manner required by the funding agency, that each program or activity conducted by the postsecondary educational institution will be conducted in compliance with this chapter and all other applicable provisions of state law prohibiting discrimination on the basis of sex. A single assurance, not more than one page in length and signed by an appropriate responsible official of the postsecondary educational institution, may be provided for all the programs and activities conducted by a postsecondary educational institution.”

