

Action/Information Item

***Joint California Student Aid Commission
and EDFUND Board of Directors Workshop***

2006-2007 Operating Agreement

[Topic 5 of the Processes established by the Commission
in response to the BSA Audit Report]

Commissioner Sally Furay, Chair of the EDFUND Board of Directors, will lead the discussion on this item. She also prepared Tab 4.A.

Commission staff has prepared a memorandum (Tab 4.B) with staff recommendations on this item.

Discussion Leader:

Sally Furay, Chair
EDFUND Board

**SUMMARY OF OPERATING AGREEMENT CURRENTLY IN EFFECT
BETWEEN CSAC AND EDFUND**

ARTICLE I (simply cites the term of the agreement – annual at present)

**ARTICLE II
EDFUND'S AGREEMENTS**

2.2: Scope of Services provided to the Commission by EdFund under the Operating Agreement: Guaranty and Other Services (these services involve the basic functions of the life cycle of the loan) – Exhibit A listing is included:

1. Guaranty/origination services
2. Default aversion and prevention
3. Lender claim adjustment and payment
4. Post-default services
5. Default loan collection services
6. Program oversight and compliance services
7. Financial and program reporting: includes federal reporting, CSAC reporting, and Invoice reimbursements
8. Communications Training and Support (coordinated with appropriate CSAC staff)
9. Business Development and Marketing
10. Policy, Research and Legislative Assistance
11. Technology Services
12. Legal Services
13. Ombudsman Services
14. Strategic Plan Objectives – develop and implement action plans to meet the Commission's Strategic Plan objectives related to the FFEL program and EdFund's administration of the program.
15. Borrower Complaint Tracking
16. Other Services (as delegated by the Commission and permitted by law). Specifically, EdFund agrees to provide the services listed in Exhibit B: these services are Supply Services, Report Distribution, Mail Processing Services, Printing Services, Security Services, Warehouse Services, Transportation Services, Records Management, Common Area Usage, Telecommunications Services, Regional Office Services, Staff Training and Development Services, Other Services as requested by the Commission, Sublease for Space).

2.3 Processing System

2.4 Performance Goals and Expectations

- Under Exhibit C, this section lists in broad outlines the following topics: Guiding Principles, Governance Policies, Commission's Goals for EdFund, and EdFund's Strategies
- Under Exhibit D, Performance Expectations for Other Support Services, this section includes many of the same items as Exhibit B under #16 above: Supply Services, Report Distribution, Mail Processing Services, Printing Services, Security Services, Warehouse Services, Transportation Services, Common Area Usage, Telecommunications Services, Regional Office Services, Staff Training and Development Services, and Other Services (Publication, Research, Customer survey, and similar topics)

2.5 Compliance with FFEL Program Requirements

2.6 Compliance with Commission Policies

2.7 EDFUND Policies

- “Corporate Governance Policy: EDFUND agrees to develop, implement, and maintain written policies and procedures as are necessary for EDFUND to fully comply with this Agreement. Proposed policies having a potential material effect on the Operating Fund...shall be submitted to the CSAC/EDFUND Financial and Policy Review Team for review and comments. The Commission recognizes the EDFUND Board of Directors’ responsibilities to make business decisions pursuant to the California Corporations Code; however, EDFUND policies and procedures shall be available for review by the Commission.”
- “Financial Aid and Information Development Policy. Nothing in this Agreement shall be construed as delegating to EDFUND the Commission’s responsibilities for policy development and administration with respect to financial aid administration, including policy relating to the administration of the FFEL Program and information development....”

2.8 Annual Business Plan and Operating Budget.

2.9 Assets

2.10 Civil Service Employees

2.11 Insurance (includes General Liability, Workers Comp, D & O, and Automobile)

ARTICLE III

California Student Aid Commission’s Agreements

3.1 Status as Guarantor

3.2 Compliance with FFEL Program Requirements

3.3 Annual Summary Business Plan and Operating Budget Approval

3.4 and 3.5 Scope of Services (one service listed in Exhibit E) and Review and Approvals

3.6 Review and Assessment of Required Reports. Exhibit F includes 10 Annual Reports, 11 Quarterly Reports, 9 Monthly Reports and Invoices, 3 Special Reports, and 7 or 8 Reports/Copies as approved or issued. Some of about 40 reports were highlighted by CSAC staff, others were not, so we may need to review these more carefully, especially since the Operating Agreement text of 3.6 concludes by saying that “The Commission agrees that it will review and assess the need for the reports listed in Exhibit F and eliminate any that are no longer necessary.”

ARTICLE IV

FFEL Program Funds, Payments to EdFund and/or Commission

4.1 FFEL Program Funds. (Commission maintains Student Loan Operating Fund, Federal Fund)

4.2 Reimbursement of EDFUND Expenses

4.3 EDFUND Incentive Compensation Plans

- Variable Pay Plans
- Executive Performance Payment at the Discretion of the Board (under approved Policy).

4.4 Use of Operating Surplus

4.5 Investment of EdFund Cash

4.6 Travel Expenses

4.7 Advances

4.8 Reimbursement to the Commission

ARTICLE V

Effective Date, Renewal, Assignment and Termination

ARTICLE VI

Indemnification

ARTICLE VII

Reports, Audits, Examination of Records and Confidentiality

- 7.1 Reports
- 7.2 Commission Oversight and Audits
- 7.3 External Audits
- 7.4 Third Party Audits
- 7.5. Audit Issues or Findings
- 7.6 Custodian of Records, Examination
- 7.7 Confidentiality

ARTICLE VIII

General Provisions

This section includes Corporate Obligation, Waiver, Amendments, Governing Law, Continuing Covenants, Notice, Force Majeure, Cooperation between Parties, Duly Authorized, Contract Managers, and Binding Arbitration.

CALIFORNIA STUDENT AID COMMISSION

ADMINISTRATION

MEMORANDUM

DATE: JULY 18, 2006

TO: COMMISSIONERS

FROM: JANET MCDUFFIE
CHIEF, MANAGEMENT SERVICES DIVISION AND
ACTING CHIEF, FEDERAL POLICY & PROGRAMS DIVISION

SUBJECT: OPERATING AGREEMENT AMENDMENT/EXTENSION AND TIMELINE

The following information is provided to you for review and discussion regarding the 2006-07 Operating Agreement, Agenda Item 4 of the July 26, 2006 Joint Commission/EDFUND Board Workshop.

First implemented in October 2002, the current Operating Agreement between the Commission and EDFUND has been extended for the past three fiscal years with minor revisions and is set to expire on September 30, 2006.

California Education Code Section 69522(d)(2) requires the Commission to submit the Operating Agreement to the Department of Finance (DOF) and the Joint Legislative Budget Committee (JLBC) prior to Commission approval. Neither DOF nor JLBC provided comments to the Operating Agreement amendments last year; however DOF noted that the Commission did not provide 45 days for DOF review. The DOF letter is included for your review. (Attachment 1)

Recent and past Bureau of State Audit (BSA) audits include findings and recommendations to revise the current Operating Agreement. Additionally, the most recent Commission Performance Review of EDFUND (June 2005) concluded that the current Operating Agreement is outdated and needs to be revised. The BSA and Commission Performance Review findings and recommendations are included as Attachment 3.

At the April 20, 2006 Commission meeting the Commission approved the establishment of a Special Committee whose responsibilities include developing a new draft of the Operating Agreement for review and approval by the Board and Commission.

Given the timing, it is unlikely that the Commission will be able to implement a new Operating Agreement by October 1, 2006; thus, a fourth extension of the Operating Agreement is required. Attachment 2 is a draft amendment/extension.



Commission Staff Recommendations:

To demonstrate moving forward on BSA recommendations, Commission staff recommends the following:

1. Approve the draft Operating Agreement three-month amendment/extension and authorize the Executive Director to execute an extension to December 31, 2006, provided the agreement remains substantially the same after a review by DOF and JLBC. (Commission staff will immediately forward the draft amendment/extension to DOF and JLBC to satisfy regulatory requirements.) See Attachment 2.
2. Instruct staff to immediately proceed with developing a new Operating Agreement with an effective date of January 1, 2007 that includes all the findings and recommendations addressed by previous BSA audits, the June 2005 Commission's Performance Review of EDFUND as indicated in Attachment 3. Staff will also include recommendations provided by the Special Committee.
3. Approve the new Operating Agreement development tentative timeline. (Attachment 4)

**DEPARTMENT OF
FINANCE**

ARNOLD SCHWARZENEGGER, GOVERNOR

915 L STREET ■ SACRAMENTO, CA ■ 95814-3706 ■ WWW.DOF.CA.GOV

September 22, 2005

Ms. Diana Fuentes-Michel
Executive Director
California Student Aid Commission
P.O. Box 419026
Rancho Cordova, CA 95741-9026

Dear Ms. Fuentes-Michel:

Diana

We are in receipt of the Operating Agreement between the California Student Aid Commission (Commission) and its auxiliary, EdFund, and a draft amendment/extension to the agreement for the period October 1, 2005 to September 30, 2006, as transmitted to us on September 13, 2005. As requested, we have reviewed the documents and found them to be consistent with the prior agreements between the two entities. As such, we have no comments or concerns to note about the documents.

While we welcome the opportunity to review these documents as provided in law, we note that the Commission gave us considerably less time (ten calendar days) to review the documents this year than the 45 days that the Commission provided last year and the 45 days that the statute seems to provide for this review. Even though we were able to complete our review within the time frame provided this year, this may not always be the case due to competing work priorities. In the future, we request that the Commission provide us sufficient time to review the documents and not assume that a non-response within the Commission's timeframe is an indication of acceptance by the Department of Finance.

Thank you for the opportunity to review these documents.

Sincerely,

A handwritten signature in black ink, appearing to read 'Lynn', is positioned above the typed name.

Lynn Podesto
Assistant Program Budget Manager

AMENDMENT/EXTENSION

This Amendment dated October 1, 2006 hereby amends the Operating Agreement by and between the California Student Aid Commission and EDFUND entered into on October 1, 2002 and amended on October 1, 2003, October 1, 2004 and on October 1, 2005, as follows:

1. The term of the Agreement shall be extended for one (1) year, until **December 31, 2006**, unless sooner terminated under Article V.
2. The "California Student Aid Commission's Performance Goals for EDFUND" as contained in the Business Plan pursuant to Exhibit C of the Agreement shall mean the "High-level Organizational Metrics" contained in the 2006-07 Loan Program Business Plan. The Commission will evaluate EDFUND's accomplishments of these goals in the context of the actual competitive student loan industry environment and national economy during the year.

All other terms and conditions of the Agreement shall remain unchanged.

California Student Aid Commission

EDFUND

By: _____
Diana Fuentes-Michel
Executive Director

By: _____
Sam Kipp
President

2006-07 OPERATING AGREEMENT

Based on recent and previous BSA audits and the Commission's June 2005 Performance Review, the following key provisions must be included in the next Operating Agreement.

1. ROLES AND RESPONSIBILITIES

In April 2006, the BSA audit concluded that the "Student Aid and EDFUND have been unable to agree on a new Operating Agreement for the FFEL Program that delineates their respective roles." (Page 31 – BSA Audit 2005-120) BSA recommended that the Commission "ensures that the roles and responsibilities it delineates for itself and EDFUND do not inappropriately cede its statutory responsibilities to EDFUND." (Page 34 – BSA Audit 2005-120)

The Commission's June 2005 Performance Review stated that "Commission management must be able to evaluate EDFUND's performance in a timely manner through a well defined operating agreement that avoids confusion about roles and responsibilities..." (Page 4 – Commission's Performance Review of EDFUND June 2005)

2. INFORMATION SYSTEM

For fiscal years 2001-02, 2002-03, 2003-04 and 2004-05 the Bureau of State Audits (BSA) found that the Operating Agreement between the Commission and EDFUND does not detail the Commission's expectations for the operation of the information technology system that maintains the records for the loan program, such as requirements for information security, the performance of a security risk assessment, and development of an information security program plan. BSA recommended that "Student Aid should amend its operating agreement with its auxiliary organization to specify its expectations related to the control structure over the information system."

3. CONTRACTING

The April 2006, BSA audit recommended that the Commission "amend its operating agreement to require purchases of goods and services incurred by EDFUND to be reimbursed pursuant to procurement and contracting policies approved by the executive director of Student Aid." (Page 76 – BSA Audit 2005-120)

The Commission's June 2005 Performance Review recommended that the "EDFUND Board re-examine the organizations contracting policies and procedures and determine if these should be strengthened or changed." (Page 3 – Commission's Performance Review of EDFUND June 2005)

In May 2003, BSA recommended that “Student Aid, through the operating agreement with its auxiliary organization, require that the auxiliary organization use best business practices and follow state contracting laws as applicable, such as not awarding consulting contracts to firms that recommended or identified work in a previous engagement.” (Page 30 – BSA Audit 2002-002)

4. PERFORMANCE REVIEWS

The current Operating Agreement must be updated to reflect changes in the California Education Code regarding regular performance evaluations.

In 2004, the following was added to the California Education Code (CEC).

CEC 69522(c)(2) states that “The implementation and effectuation of the auxiliary organization shall be carried out so as to enhance the administration and delivery of commission programs and services. The Commission shall conduct regular performance evaluations of the operation of auxiliary organizations in furtherance of its fiscal and fiduciary responsibilities for approved programs.”

5. TRAVEL POLICY

In April 2006, BSA recommended that the Commission “amend its operating agreement to require EDFUND to establish a travel policy that is consistent with the State’s policy.” (Page 76 – BSA Audit 2005-120)

6. INCENTIVE COMPENSATION

The April 2006 BSA audit recommended that the Commission “modify its policy statement and guidelines memorandum titled EDFUND *Incentive Compensation Plans* to ensure that EDFUND’s executive management team does not receive a bonus if the FFEL Program or Operating Fund realizes a deficit.” (Page 75 - BSA Audit 2005-120)

TENTATIVE TIMELINE

Date	Event	Recommended Action
AMENDMENT/EXTENSION		
July 26-27, 2006	Joint Commission and EDFUND Workshop	<ul style="list-style-type: none"> • Approve the draft Operating Agreement three-month amendment/extension and authorize the Executive Director to execute the extension to December 31, 2006. • Direct staff to draft a new Operating Agreement that includes provisions listed in Attachment 3. • Approve timeline Attachment 4.
July 31, 2006	California Education Code-Section 69522(d)(2)	<ul style="list-style-type: none"> • Submit draft Operating Agreement three-month amendment/extension to Department of Finance and Joint Legislative Budget Committee.
August 18, 2006	EDFUND Board Meeting	
September 7-8, 2006	Commission Meeting	
September 13, 2006	California Education Code Section 69522(d)(2)	<ul style="list-style-type: none"> • Comments/proposed changes due from DOF/JLBC
September 25, 2006	Special Commission Meeting (TBD) Teleconference	<ul style="list-style-type: none"> • If necessary, review proposed changes by DOF/JLBC and authorize the Executive Director to execute the extension to December 31, 2006.
NEW OPERATING AGREEMENT		
October 16, 2006	Special Commission Meeting (to be scheduled) Teleconference	<ul style="list-style-type: none"> • Approve draft Operating Agreement and authorize Executive Director to execute new Operating Agreement.
October 25, 2006	California Education Code-Section 69522(d)(2)	<ul style="list-style-type: none"> • Submit draft Operating Agreement to DOF and JLBC
November 14, 2006	EDFUND Board Meeting	
November 29-30, 2006	Commission Meeting	
December 8, 2006	California Education Code-Section 69522(d)(2)	<ul style="list-style-type: none"> • Comments/proposed changes due from DOF/JLBC
December 18, 2006	Special Commission Meeting (to be scheduled) Teleconference	<ul style="list-style-type: none"> • Approve new Operating Agreement and authorize Executive Director to execute.