

**Action /Information Item**

***Personnel, Evaluation and Nominations Committee***

Consideration of Whether the Commission Should Designate a Commissioner as  
a Director of the EdFUND Board

---

***Issue***

Should the Commission consider appointing a Commissioner as a director on the EdFund board?

***Recommendation***

Commission staff recommends that the Commission take no action to appoint Commissioners to the EdFund board for the following reasons:

- 1) The Bureau of State Audits' concern questioning the ability of a Commissioner on the board to oversee his or her own decisions is credible and persuasive; and
- 2) The Commission has other means of effectively overseeing the loan program activities and EdFund.

***Discussion***

United States law establishes the Federal Family Education Loan Program (FFEL Program) and specifies program requirements, while federal regulations clarify and describe those requirements in more detail.

The California Education Code authorizes the State to participate in the FFEL Program and designates the California Student Aid Commission as a state guarantee agency for purposes of the State's participation in the FFEL Program.

The Education Code also authorizes the Commission to establish an auxiliary organization as a non-profit corporation for purposes of the administration and operations of the Commission's FFEL Program activities. Under the federal regulations governing the FFEL Program, the Commission must supervise its auxiliary organization, set policies and procedures for the auxiliary organization, and retains full responsibility for the operation of the State's FFEL Program activities.

The Education Code also requires the Commission to exercise administrative and policy responsibilities over its auxiliary organization. Among other things, the Education Code specifies that the Commission is to nominate and appoint the members of the board of the auxiliary organization, and must include at least one student director and one director who is an employee of the auxiliary organization.

The Commission incorporated EdFund as its auxiliary organization in 1997. The bylaws of EdFund provide that the board of EdFund consists of 13 members, including the student director and EdFund employee director. The Executive Director of the Commission and President of EdFund are *ex officio*, non-voting members of the EdFund board. The bylaws also provide that the Commission designates the members of the EdFund board.

The Commission has designated Commissioners as members of the EdFund board, but the number of Commissioners has varied over time. Commissioners have constituted a majority or minority of the EdFund board at various times.

As a result of concerns in the Legislature over the Commission's oversight of FFEL Program functions and of EdFund in particular, the Bureau of State Audits conducted a performance review of the Commission. The Bureau issued its report in April 2006, identifying a number of concerns and providing a number of recommendations for changes in the Commission's oversight process.

Pages 70-71 of the Bureau of State Audits' report are included with this Tab. On these pages, the Bureau questioned whether a Commissioner who is also an EdFund board member can objectively perform his or her duty of reviewing EdFund's business plan and operating budget when he or she has played a role in authorizing and approving the expenses. Among other things, the Bureau recommended that the Commission "[c]onsider removing Student Aid commissioners from the EDFUND board."

The Commission considered the recommendation and, at its June 22, 2006, meeting, voted to reduce the number of Commissioners on the EdFund board from four to one. The Commission maintained one seat on the board in deference to then-Commissioner Sally Furay, who was at that time chair of the EdFund Board. Commissioner Furay continued to serve as the sole Commissioner on the EdFund Board until February 29, 2008, at which time her service on the Commission expired. She continues to serve as chair of the EdFund board as a non-Commissioner director pursuant to the Commission's vote at the Commission's November 29, 2007, meeting.

There are no current Commissioners on the EdFund board.

As the Committee is aware, the Legislature has authorized the Department of Finance to sell state student loan guarantee program assets, i.e., the "sale of EdFund." (Educ. Code, § 69521.3.) The Legislature gave the Department of Finance general oversight authority over the loan program activities by requiring Department of Finance approval before any Commission actions affecting the loan program become effective. (Educ. Code, § 69521.5(c)(3).)

Committee staff agrees with the concerns of the Bureau of State Audits that it is problematic whether a commissioner could appropriately oversee his or her own decision made as a member of the EdFund board.

In the past, some commissioners have been concerned with whether they could properly oversee loan program activities and EdFund without participating as directors on the EdFund board. However, the Commission has other means of effectively overseeing the loan program activities and EdFund. Staff continues to provide general oversight of EdFund functions and reports to the Commission on loan program issues as necessary. Further, the

Department of Finance has ultimate approval authority over actions affecting the loan program until a sale of state student loan guarantee program assets is completed.

Therefore, Commission staff recommends no action to appoint Commissioners to the EdFund board.

***Responsible person:*** Keith Yamanaka  
Chief Deputy Director

## **California Student Aid Commission:**

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



April 2006  
2005-120



# CALIFORNIA STATE AUDITOR

Tab 2.a

ELAINE M. HOWLE  
STATE AUDITOR

STEVEN M. HENDRICKSON  
CHIEF DEPUTY STATE AUDITOR

April 20, 2006

2005-120

The Governor of California  
President pro Tempore of the Senate  
Speaker of the Assembly  
State Capitol  
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the California Student Aid Commission's (Student Aid) administration of the Federal Family Education Loan (FFEL) Program.

This report concludes that changes in the federal laws governing the FFEL Program raise concerns about whether Student Aid will be able to remain competitive with other guaranty agencies. Specifically, one change requires guaranty agencies to either charge borrowers a 1 percent federal default fee on the principal amount of all FFEL Program loans issued after July 1, 2006, or transfer an equal amount from nonfederal sources into the Federal Student Loan Reserve Fund. Guaranty agencies with sufficient resources can elect to pay the fee on behalf of borrowers while agencies such as Student Aid that have limited resources will have to charge the borrowers the fee.

The report also concludes that ongoing tensions between Student Aid and EDFUND, its auxiliary organization, have been costly and have delayed the completion of critical tasks. For example, these tensions, as well as turnover in leadership at EDFUND, hampered Student Aid's ability to renegotiate a revenue agreement with the U.S. Department of Education. At least \$24 million more may have been generated in federal fiscal year 2005 if the agreement had been finalized. This same lack of cooperation has delayed attempts to expand and diversify EDFUND's financial services and possibly generate additional revenue that could have been used for California students.

Finally, Student Aid has maintained poor oversight over EDFUND. For instance, Student Aid approved sizable bonuses for EDFUND's executive staff despite the fact that the FFEL Program had an operating deficit, and its policy for setting executive salaries does not meet federal requirements. Student Aid also has not ensured that EDFUND travel and business expense policies are fiscally conservative, which results in less funding available for Student Aid to fulfill its mission.

Respectfully submitted,

ELAINE M. HOWLE  
State Auditor

---

## BUREAU OF STATE AUDITS

555 Capitol Mall, Suite 300, Sacramento, California 95814 Telephone: (916) 445-0255 Fax: (916) 327-0019 [www.bsa.ca.gov/bsa](http://www.bsa.ca.gov/bsa)

assistant general counsel manage the relationship with the temporary external general counsel. Authorizing, executing, or consummating transactions, such as approving invoices, hinders the chief internal auditor's ability to objectively and independently evaluate the internal controls related to those transactions. As such, simultaneous occupation of both positions is potentially an organizational and personal impairment of independence. After we brought this issue to EDFUND's attention, it assigned the legal duties to staff other than the chief internal auditor.

### **The Composition of the EDFUND Board Could Impair Student Aid's Decision Making**

State law requires Student Aid to oversee the development and operations of EDFUND and to nominate and appoint EDFUND's board. Further, state law requires Student Aid to maintain its responsibility for financial aid program administration and policy leadership program evaluation. Therefore, whether in fact or in appearance, a commissioner may have a perceived conflict with overseeing the operations of an organization for which he or she is also a board member. Additionally, the Student Aid executive director, as a voting member, may have a similar perceived conflict.

State law also requires one member of the board to be an employee of EDFUND and one member to be a student enrolled in a California public or private postsecondary educational institution. Student Aid determines the remaining composition of the board. Since the creation of EDFUND, Student Aid commissioners have been serving as EDFUND board members. In its May 23, 2005 meeting, Student Aid removed six EDFUND board members due to concerns about the governance of the FFEL Program. According to the chair of Student Aid, the decision allowed the commissioners to make a more responsible decision regarding the program's future governance.

Among other things, EDFUND board members must approve all of EDFUND's expenses and fund authorizations. The operating agreement between Student Aid and EDFUND requires Student Aid to review and approve EDFUND's business plan and annual operating budget. Moreover, any material expenditure or material change in operations or corporate policies outside of the plan and budget must have Student Aid's prior approval. Thus, we question whether a commissioner who is also an EDFUND board member can objectively perform his or her duty

of reviewing EDFUND's business plan and operating budget when he or she has played a role in authorizing and approving the expenses.

Allowing commissioners to serve as board members also can create a barrier to Student Aid's oversight responsibilities. For instance, in November 2004, a commissioner who was also the vice chair of the EDFUND board sent an e-mail to Student Aid's executive director and another commissioner complaining about the scope of a performance review of EDFUND that Student Aid had hired consultants to perform. The vice chair questioned why an "annual" performance review included a scope that was going back five years. As a commissioner appointed by the governor to act in the best interests of Student Aid, the commissioner should embrace the intentions of Student Aid staff to conduct a comprehensive review of EDFUND operations. Moreover, state law does not limit reviews conducted by Student Aid to a one-year period. Rather, it requires Student Aid to conduct regular performance evaluations of EDFUND's operations in furtherance of its fiscal and fiduciary responsibilities for approved programs. Additionally, the vice chair stated that she, along with other board members, were well aware that the executive director and Student Aid oversight personnel do not trust the EDFUND board or its staff. The commissioner's perspectives illustrate the problems with appointing commissioners to serve as board members and ultimately could hamper Student Aid's ability to oversee the operations of EDFUND effectively.

Similarly, allowing the executive director to be a voting board member can create a barrier to Student Aid's oversight responsibility. According to the operating agreement between Student Aid and EDFUND, Student Aid's executive director is responsible for reviewing EDFUND's business plan and annual operating budget and approving EDFUND employee bonus plans and travel policy. Thus, we also question whether the executive director, in her role as a voting board member, can perform her duties objectively. The chair of Student Aid agrees that it would be best if commissioners do not serve as board members and that the executive director serve only as a nonvoting board member.