

California Student Aid Commission

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

REPORT NUMBER 2005-120, APRIL 2006

California Student Aid Commission's response as of April 2007

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

Finding #1: Federal changes will affect Student Aid's ability to earn surplus funds from the Federal Family Education Loan (FFEL) Program.

Student Aid's ability to generate an operating surplus from the FFEL Program will be affected significantly by a change required under the Federal Higher Education Reconciliation Act of 2005 (Reconciliation Act) contained in the Federal Deficit Reduction Omnibus Reconciliation Act of 2005. How Student Aid and its competitors choose to implement one change in particular ultimately could determine whether the State should continue to participate as a guaranty agency in the FFEL Program. The change requires guaranty agencies to charge borrowers a 1 percent federal default fee on the principal amount of all FFEL Program loans issued after July 1, 2006, and deposit the proceeds into the Federal Student Loan Reserve Fund (Federal Fund) or transfer an equal amount from nonfederal sources into the Federal Fund. Guaranty agencies with sufficient resources can elect to pay the fee on behalf of borrowers, while agencies with limited resources, such as Student Aid, will have to charge borrowers the fee. These guaranty agencies will be at a distinct competitive disadvantage and may experience a reduction in their market share.

EDFUND staff performed two analyses to determine the impact on FFEL Program operations depending on whether or not other guaranty agencies elect to pay the federal default fee on behalf of borrowers. However, EDFUND's legal counsel asserts that these analyses are confidential and proprietary. Thus, we cannot discuss the specific details of the analyses. Nevertheless, recent announcements by some of the other guaranty agencies indicate that they will not charge borrowers the fee. Conversely, Student Aid has announced it would charge borrowers the fee.

Because of the recent announcements by other guarantors, it will be necessary for EDFUND to revise its forecasts for federal fiscal years 2006 and 2007. It is our belief that FFEL Program revenues could be reduced to the point where EDFUND's role as an auxiliary organization assisting Student Aid in administering the program is

Audit Highlights . . .

Our review of the California Student Aid Commission (Student Aid) and EDFUND's administration of the Federal Family Education Loan (FFEL) Program revealed the following:

- » *Changes in federal laws governing the FFEL Program raise doubts that the State will be able to sustain the program.*
- » *Ongoing tensions between Student Aid and EDFUND have hampered Student Aid's ability to renegotiate a revenue agreement with the U.S. Department of Education, which may have cost the State at least \$24 million in federal fiscal year 2005. These tensions also have delayed attempts to expand and diversify EDFUND's financial services.*
- » *Student Aid approved sizeable bonuses for EDFUND executive staff even when the FFEL Program had an operating deficit.*
- » *Student Aid has maintained poor oversight over EDFUND. For example, Student Aid has not ensured that EDFUND travel and business policies are fiscally conservative, which results in less funding available to Student Aid to fulfill its mission.*

no longer warranted. EDFUND states that it has many tactics to minimize the impact of any changes in its competitive position. These tactics include strategies it and other guarantors in the industry use to maintain effective relations with and competitive services for schools, and to work with lenders to strike new relationships that include payment of the default fee. However, EDFUND cannot determine what, if any, impact these tactics will have on its ability to remain competitive in the student loan guaranty market.

The Reconciliation Act imposes other changes that likely will reduce Student Aid's FFEL Program revenues. Specifically, on or after October 1, 2006, the Reconciliation Act prohibits guaranty agencies from charging borrowers collection costs that exceed 18.5 percent of the outstanding principal and interest of a defaulted loan that is paid off through consolidation by the borrower. It also requires the agencies to remit to the U. S. Department of Education (Education) 8.5 percent of the collection charge. Effective October 1, 2009, the Reconciliation Act will require guaranty agencies to remit to Education the entire amount of collection costs for each defaulted loan that is paid off with excess consolidation proceeds, which are the proceeds of consolidated defaulted loans that exceed 45 percent of the guaranty agency's total collections on defaulted loans in each federal fiscal year. Because it has relied so heavily in the past on using consolidations to collect on defaulted loans, these changes will almost certainly result in a decrease to the portion of Student Aid's net recoveries on loan defaults that result from this collection method. Although these changes in federal law do not become operative until federal fiscal year 2010, according to EDFUND it is aggressively reducing its use of consolidations to collect on defaulted loans.

To manage the FFEL Program in a manner that benefits the State, we recommended that Student Aid continue to reassess the financial impact on the FFEL Program caused by changes in the federal Higher Education Act and the recent announcements made by some large guaranty agencies that they will pay the federal default fee for borrowers. Additionally, Student Aid should monitor EDFUND's progress toward reducing its reliance on defaulted loan consolidations.

To determine if it remains beneficial for the State to participate in the FFEL Program as a guaranty agency, we recommended that the Legislature closely monitor Student Aid and EDFUND to ensure that they are able to remain competitive with other FFEL Program guaranty agencies.

Additionally, we recommended that the Legislature closely monitor the Student Loan Operating Fund (Operating Fund) to ensure that the FFEL Program is generating a sufficient operating surplus so that it can supplement funding for Student Aid's other services and programs. If it is unable to generate a sufficient operating surplus, the Legislature should require Student Aid to dissolve EDFUND and contract with another guaranty agency to administer the FFEL Program. The contract should include, among other things, a provision that allows Student Aid to receive a share of the revenues generated by the guaranty agency, which then could be used to supplement funding for Student Aid's other financial aid programs. In addition, the contract should include a provision for Student Aid to hire external auditors to ensure that the guaranty agency is complying with federal laws and regulations. Alternatively, the Legislature could reconsider the need for a state-designated guaranty agency.

Student Aid's Action: Partial corrective action taken.

Student Aid and EDFUND staff continue to inform and discuss with the commission and EDFUND board members the fiscal impact caused by changes in the federal Higher Education Act. Additionally, Student Aid paid the federal default fee on behalf of borrowers on loans issued from July 1, 2006, through September 30, 2006, which, according to Student Aid, accounts for the bulk of the fee incurred during the entire academic year. According to Student Aid, it determined that it would not be able to pay the fee on behalf of all borrowers for loans guaranteed on or after October 1, 2006. To remain competitive in the market, private lenders—those who provide the funds for the loans made to the FFEL Program, such as banks and other financial institutions—decided to pay the fee for loans guaranteed from October 1, 2006, through June 30, 2007. Beginning July 1, 2007, EDFUND implemented an annual default fee strategy in which EDFUND and lenders will form

partnerships beginning with the 2007–08 academic year to pay the federal default fee through nonfederal sources. This cost sharing policy was designed to pay 100 percent of the federal default fee on behalf of borrowers and be open to any lender who voluntarily agreed to participate.

Furthermore, EDFUND has successfully shifted its collection strategy and has seen an increase in loan rehabilitations, wage garnishments, and voluntary borrower payments while moving away from a focus on consolidations.

However, new proposed federal changes could again affect FFEL Program revenues. As of September 7, 2007, both houses of Congress approved House of Representatives Bill 2669 (H.R. 2669), which will reduce the guaranty agency collection retention rate on borrower payments from 23 percent to 16 percent beginning October 1, 2007. H.R. 2669 also contains provisions that will reduce the account maintenance fee paid to FFEL Program guarantors from 0.10 percent to 0.06 percent of the original principal amount of outstanding loans issued by the guaranty agency. These changes are likely to significantly impact the revenues earned by FFEL Program guarantors throughout the student loan industry. The President signed H.R. 2669 on September 27, 2007.

Legislative Action: Legislation enacted.

Senate Bill 89 (SB 89), an urgency measure enacted as Chapter 182, Statutes of 2007, which took effect immediately, may affect the ownership of EDFUND. This bill authorizes the director of Finance to act as an agent for the State in the sale and transfer of the student loan guarantee portfolio and certain related assets and liabilities of the FFEL Program held by EDFUND. Alternatively, this bill authorizes the director of Finance to enter into an arrangement other than the sale and transfer of EDFUND's assets if the director, in consultation with the state treasurer, determines that arrangement will meet the goals specified in SB 89. SB 89 also prohibits the commission from authorizing EDFUND to perform any new or additional services unless they are deemed necessary or convenient by the Finance director for the operation of the loan program or for maximizing the value of the state student loan guarantee program. Similarly, the director must approve any expenditure by EDFUND. Moreover, SB 89 provides that all actions, approvals, and directions of the commission affecting the state student loan guarantee program are effective only upon approval of the director. Thus, the Finance director now has significant authority over the commission and EDFUND. Finally, the bill requires the Finance director to conduct the activities authorized by SB 89 no later than January 10, 2009.

Finding #2: Tensions between Student Aid and EDFUND have delayed critical activities, resulting in lost revenue.

The inability of Student Aid and EDFUND to agree on the role of each organization and the general lack of cooperation between the two has hampered efforts to renegotiate an important agreement with Education that may have resulted in a lost opportunity to receive at least \$24 million in federal fiscal year 2005. Further, these same problems have hindered attempts to expand the financial aid services provided by EDFUND, thereby preventing it from generating additional revenues that could have been used for students. Finally, Student Aid and EDFUND have yet to clarify the roles and responsibilities of each organization despite several attempts to do so.

Student Aid failed to renegotiate its voluntary flexible agreement (VFA) with Education in a timely manner. Disputes between Student Aid and EDFUND, along with turnover in EDFUND's executive management team, have contributed to delays in Student Aid's submission of a VFA proposal to Education. In federal fiscal year 2005, EDFUND budgeted \$30 million in VFA revenues. However, it received only \$6 million. According to Education's state agency liaison, he informed Student Aid and EDFUND in June 2004 that they would not receive any VFA funding beyond federal fiscal year 2004 until the agreement was renegotiated to obtain cost neutrality. Thus, Student Aid may not be able to receive the additional \$24 million that EDFUND budgeted for federal fiscal year 2005 or any other funds it may have been eligible to receive. If Education and Student Aid are unable to complete their renegotiations and comply with the VFA requirements before September 30, 2006, Student Aid also risks losing the opportunity to receive the \$31.4 million that EDFUND budgeted for federal fiscal year 2006.

As discussed previously, federal changes will affect Student Aid's ability to earn surplus funds from the FFEL Program. Thus, the State's ability to continue to generate sufficient FFEL Program revenue to support its other programs and services may rely upon Student Aid's and EDFUND's ability to obtain additional sources of revenue from a diverse set of student loan-related business activities. Currently, neither Student Aid nor EDFUND has a formal plan that specifically identifies the business diversification opportunities they will target.

Student Aid and EDFUND also do not agree on the appropriate role each should have in the administration of the FFEL Program. Despite attempting to craft a roles and responsibilities document (document) since at least May 2005, they have yet to finalize one. Furthermore, based on our review of the ninth version of the two-page draft document, Student Aid may be inappropriately ceding some of its responsibilities to EDFUND. For example, it states that EDFUND has the primary role in operating all aspects of the FFEL Program. However, federal law requires the guaranty agency that chooses to delegate the performance of the FFEL Program function to another entity to ensure that the other entity complies with the program requirements and to monitor its activities. In addition, federal regulations require the state agency to maintain full responsibility for the operation of the FFEL Program when the program is administered by a nonprofit organization.

We recommended that Student Aid ensure that critical tasks, including the renegotiation of its VFA with Education and the development of a diversification plan, are completed. Student Aid should also ensure that the roles and responsibilities it delineates for itself and EDFUND do not inappropriately cede its statutory responsibilities to EDFUND. We also recommended that the Legislature closely monitor Student Aid's progress toward completing critical tasks, including the renegotiation of its VFA with Education and the development of a business diversification plan.

Student Aid's Action: Partial corrective action taken.

Student Aid's original VFA remains in place and it was successful in collecting \$28 million for federal fiscal year 2005. Student Aid and EDFUND staff met with Education to discuss Student Aid's participation in the FFEL Program. However, Education has not renegotiated Student Aid's VFA or the VFAs of the other four guaranty agencies that currently have one. Student Aid officials believe that the president's proposed national budget, which would eliminate all VFAs, may have contributed to Education's not moving forward in renegotiations.

Student Aid states that when it received legislative approval to diversify its operations, the Operating Fund had sufficient cash balances to diversify. Since then, the State had redirected approximately \$300 million in operating funds to pay for non-FFEL Program general fund obligations. The commissioners and board members believe that insufficient cash reserves preclude any major initiatives to diversify in the near term.

Finally, Student Aid reported that it has been working closely with a consultant and staff to delineate the roles and responsibilities of the commission, the EDFUND board, and the staff of both organizations. As a result of these efforts, the commission and EDFUND board members approved a new operating agreement and submitted it to the Department of Finance (Finance) and the Joint Legislative Budget Committee for their comment in May 2007. Furthermore, Student Aid and EDFUND finalized a roles and responsibilities document that was approved by the commission on May 1, 2007.

Legislative Action: Legislation enacted.

Senate Bill 89 (SB 89), an urgency measure enacted as Chapter 182, Statutes of 2007, which took effect immediately, may affect the ownership of EDFUND. This bill authorizes the director of Finance to act as an agent for the State in the sale and transfer of the student loan guarantee portfolio and certain related assets and liabilities of the FFEL Program held by EDFUND. Alternatively, this bill authorizes the director of Finance to enter into an arrangement other than the sale and transfer of EDFUND's assets if the director, in consultation with the state treasurer, determines that arrangement will meet the goals specified in SB 89. SB 89 also prohibits the

commission from authorizing EDFUND to perform any new or additional services unless they are deemed necessary or convenient by the Finance director for the operation of the loan program or for maximizing the value of the state student loan guarantee program. Similarly, the director must approve any expenditure by EDFUND. Moreover, SB 89 provides that all actions, approvals, and directions of the commission affecting the state student loan guarantee program are effective only upon approval of the director. Thus, the Finance director now has significant authority over the commission and EDFUND. Finally, the bill requires the Finance director to conduct the activities authorized by SB 89 no later than January 10, 2009.

Finding #3: Student Aid's process for establishing executive salaries and bonuses for EDFUND requires improvement.

EDFUND created its current policy for setting executive salaries in response to federal regulations ensuring reasonable compensation for employees who exercise substantial control over nonprofit corporations. Under the regulations, payments under a compensation arrangement are presumed to be at fair market value if the arrangement is approved in advance by an authorized body of EDFUND composed of individuals without a conflict of interest, the authorized body obtained and relied upon appropriate comparability data, and the body adequately documented its basis for determination. Adequate documentation consists of the terms, approval date, members of the authorized body present, members who voted, comparability data and how it was obtained, and any actions taken with respect to consideration of the transaction by anyone who is a member of the body but who had a conflict of interest. However, EDFUND's policy does not address board members who have a conflict of interest. In addition, we question the manner in which EDFUND carried out its salary comparison. Specifically, although EDFUND uses surveys to assist in establishing salaries for its executives, it does not limit data to survey sources related to the financial industry. Furthermore, EDFUND cannot demonstrate that it follows its executive salary determination policy because the board and executive committee have not kept sufficient minutes of their meetings.

Student Aid's policy regarding EDFUND executive incentive compensation is also flawed. The operating agreement between Student Aid and EDFUND specifically states that EDFUND agrees to administer its executive performance payment plan in accordance with the Student Aid policy statement and guidelines memo (policy) titled *EDFUND Incentive Compensation Plans*, dated August 12, 2002.

This policy contains flaws because it allows bonuses when an operating deficit exists and excludes some FFEL Program revenues and expenses from the calculation of the Operating Fund surplus or deficit. In addition, the policy is completely discretionary and is silent on how EDFUND should determine the amount of the executive compensation pool. Finally, the policy directs the board to recommend the proposed bonus amounts, if any, for the president and the total bonus amount for the vice presidents. However, the board does not appear to use consistent criteria from one year to the next when determining the total bonus amount.

We recommended that Student Aid ensure EDFUND complies fully with federal regulations and its policy governing salary setting for its executives, including modifying its policy to address board members who have a conflict of interest and ensuring that its consultants compile comparable compensation data solely from similar financial-related organizations. Student Aid should also ensure that EDFUND determines bonuses for its president in accordance with Student Aid's policy. Further, Student Aid should modify its policy statement and guidelines memorandum titled *EDFUND Incentive Compensation Plans* to ensure that EDFUND includes all FFEL Program revenues and expenses in its calculation of the program's operating surplus or deficit and that EDFUND's executive management team does not receive a bonus if the FFEL Program or Operating Fund realizes a deficit. Finally, Student Aid should ensure that it and EDFUND's board establish guidelines to use when approving the total bonus pool amount for EDFUND's executive management team.

Student Aid's Action: Partial corrective action taken.

The EDFUND board adopted EDFUND's Executive Compensation Policy in April 2007. A compensation consulting firm has reviewed the policy and the EDFUND board obtained a legal opinion from an outside law firm to ensure the policy complied with federal regulations. The policy also addresses board member conflict of interests. Although the policy was presented to the commission in April 2007, the commission determined that more information was needed before taking any action on the policy.

The EDFUND board also adopted recommended revisions to the Student Aid Policy Statement and Guidelines Memorandum for the EDFUND Incentive Compensation plans. The revisions were presented to the commission at an April 20, 2007, meeting. During the meeting, the commission approved a precondition for inclusion in the document that stated that the year-end FFEL Program revenues must exceed expenses before bonuses will be considered. The commission also determined that more information and further discussion was necessary before considering any additional revisions to the Student Aid Policy Statement and Guidelines Memorandum for the EDFUND Incentive Compensation Plan.

Finding #4: The method used to determine nonexecutive bonuses needs to be reevaluated.

Student Aid has not fully addressed concerns raised by an assessment of EDFUND's accomplishment of performance goals. EDFUND has three bonus plans for nonexecutive employees, known as variable pay plans. Two of its three plans reward employees for both individual performance within and the overall performance of EDFUND as an organization, while the third plan is a straightforward award based on a percentage of monthly collections of defaulted loans. Organization performance goals are determined through a process outlined in the August 2002 Student Aid policy. EDFUND uses several high-level organizational metrics to measure its performance of the goals set by Student Aid.

Although its executive director has raised several concerns regarding EDFUND's method of calculating organizational performance, Student Aid has done little to fully address the issues. The executive director and president have agreed that four issues must be addressed: whether and how to recognize goals not achieved, whether and how to recognize a percentage of accomplishment above the assigned weights, whether to set a standard for acceptable variance to a goal, and how midyear budget changes may affect a goal. However, as of March 2006, little progress has been made to resolve these issues. Until these outstanding issues are resolved, EDFUND will continue to award bonuses that are not based on an accurate assessment of its organizational performance.

We recommended that Student Aid direct its executive director and EDFUND's president to resolve outstanding issues related to the methodology used to measure EDFUND's performance, which affects the bonuses for its nonexecutive employees.

Student Aid's Action: Partial corrective action taken.

Student Aid indicated that it and EDFUND have made progress in resolving the four issues identified in our report: (1) whether and how to recognize goals not achieved, (2) whether and how to recognize a percentage of accomplishment above the assigned weights, (3) whether to set a standard for acceptable variance to a goal, and (4) how midyear budget changes may affect a goal. Specifically, Student Aid states that agreement has been reached except for one area involving issues 1 and 3, which are interrelated. This area focused on the methodology that should be used to calculate turnover rate and recovery rate.

Finding #5: More funds would have been available if Student Aid had required EDFUND to follow more fiscally conservative policies.

Student Aid has not ensured that EDFUND policies are fiscally conservative. Further, EDFUND does not always comply with its business and travel expense policies. We also found a few instances in which Student Aid did not comply with the State's travel policy. Finally, EDFUND spent almost \$700,000 over five federal fiscal years from the Operating Fund for 14 events, such as holiday receptions, employee conferences, and workshops and meetings, that we reviewed. These events often included lodging and meals at upscale hotels and resorts for high-level staff, expensive guest speakers and entertainment. We also found several instances when EDFUND hosted and paid for an event and allowed family members to attend without paying their own way. We question how spending large sums of money on these types of events supports the State's mission of assisting students in achieving their educational goals.

We recommended that Student Aid amend its operating agreement to require EDFUND to establish a travel policy that is consistent with the State's policy. Additionally, it should closely monitor EDFUND expenses paid out of the Operating Fund for conferences, workshops, all-staff events, travel, and the like. Finally, it should ensure that EDFUND discontinues using Operating Fund money to pay for expenses related to nonemployees attending its company functions.

Student Aid's Action: Corrective action taken.

On September 7, 2006, Student Aid approved EDFUND's revised travel policy, which became effective on October 1, 2006. The travel policy adopts by reference the State's short-term travel reimbursement for all exempt, excluded, and represented employees. However, the travel policy includes certain exceptions such as EDFUND's use of the U.S. Internal Revenue Services' per diem rates for meals and incidental expenses and its allowable rate for personal vehicle mileage. According to EDFUND, these exceptions were necessary to reflect its status as a nonprofit public benefit corporation and its need to remain competitive with similar corporations in the industry.

On September 7, 2006, the commission approved EDFUND's new employee-wide events spending policy, which became effective on October 1, 2006. The spending policy requires EDFUND to prohibit the use of corporate funds for employee-wide benefits, except as approved by the board. EDFUND's spending policy also prohibits it from using corporate funds to subsidize the costs of guests participating in its employee-wide events.

Finally, the operating agreement between Student Aid and EDFUND includes a provision requiring an annual audit of internal controls by an independent certified public accountant. The operating agreement also requires the development of an annual oversight plan to monitor compliance with EDFUND policies.

Finding #6: EDFUND did not always comply with its contracting policies.

EDFUND's contracting policies are vague, leading to lack of guidance in contracting procedures, frequent issues of noncompliance, and questionable practices. EDFUND's policy requires its staff to procure goods and services using one of three methods—competitive bid, sole- and single-source procurement, and an urgency provision for sole-source contracts that are greater than \$100,000. In addition, the policy states that all procurements greater than \$10,000 require at least three bids unless documentation exists indicating three viable vendors decline to bid or are not available. Staff also must provide a justification memorandum or bid/cost analyses approved by an assistant vice president or someone in a higher position.

For 15 of the 16 contracts tested, we found violations ranging from lack of documentation to inadequate sole-source justification. For example, our review of 16 contracts found that EDFUND did not ensure that staff met the three bid and cost analyses requirement for 11 contracts exceeding \$10,000. Furthermore, although EDFUND's policy requires staff to submit a justification memorandum with procurements

under its competitive bid and single- and sole-source methods, it provides no guidance on what the memo or analysis should include. EDFUND's assistant general counsel acknowledges that its policy requires revision and stated that it is working toward doing so.

Finally, the operating agreement between Student Aid and EDFUND does not specifically require purchases of goods and services incurred by EDFUND to be reimbursed pursuant to a procurement and contracts policy approved by the executive director of Student Aid. Without such a provision, the State cannot ensure that EDFUND's purchases result in costs that are appropriate and reasonable.

We recommended that Student Aid ensure that EDFUND follows through on its efforts to revise its contracting policies. We also recommend that Student Aid 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.

Student Aid's Action: Corrective action taken.

On September 7, 2006, Student Aid approved EDFUND's revised procurement/contracts policy, which became effective on October 1, 2006. The policy appears to address the concerns raised by the bureau.

Finding #7: Student Aid needs to improve its oversight of EDFUND.

Student Aid has not provided sufficient oversight over EDFUND to ensure the future success of Student Aid's participation in the FFEL Program. Specifically, Student Aid circumvented state law by delegating its authority related to the approval of EDFUND's budget without amending the operating agreement. Student Aid also dismissed several policy and fiscal concerns raised by its staff responsible for analyzing these issues. Moreover, Student Aid does not always independently verify reports that it receives from EDFUND. Rather, it relies on EDFUND staff to ensure their accuracy. Finally, Student Aid has not completed several key tasks identified within its mandated performance review of EDFUND, despite its staffs' recommendations to actively pursue them. For example, neither Student Aid nor EDFUND has performed an adequate assessment of the financial risks associated with EDFUND's student loan guaranty portfolio, a critical piece of information that Student Aid should have considered before approving EDFUND's annual budgets and business plans.

We recommended that Student Aid rescind its delegation of the approval authority of EDFUND's detailed operating budget to the EDFUND board and follow through on issues raised by its staff regarding EDFUND's operations. Student Aid should also require staff to independently verify the accuracy of the reports submitted by EDFUND. Finally, it should complete key tasks outlined in the June 2005 mandated performance review of EDFUND.

Student Aid's Action: Partial corrective action taken.

Student Aid rescinded its delegation of the approval authority of EDFUND's detailed operating budget to the EDFUND board on June 22, 2006.

Student Aid reported that it and EDFUND discussed EDFUND's 2006-07 Loan Program Business Plan and Budget with staff from both organizations to discuss policy and fiscal concerns raised by Student Aid staff. Student Aid indicated that these concerns were resolved to the satisfaction of both organizations.

Student Aid reported that it has been working closely with a consultant and its staff to delineate the roles and responsibilities of both organizations. This will include establishing the appropriate oversight responsibility of Student Aid, including procedures to verify information included in reports prepared by EDFUND.

EDFUND stated that it has completed the key tasks outlined in the June 2005 mandated performance review of EDFUND. We initially reported that six tasks had not been adequately addressed. However, during a follow-up review, we confirmed that EDFUND has completed two of six tasks. As for a third task, although Student Aid and EDFUND continued to explore business diversification options, the Student Aid commissioners and EDFUND board members agree that insufficient cash reserves precludes any major initiatives to diversify in the near term. Finally, EDFUND believes that its routine day-to-day activities address the remaining three key tasks. For example, EDFUND believes it continually reassesses its marketing strategies through the annual EDFUND Loan Program Business Plan, which includes short-term marketing goals for the upcoming year. Further, according to EDFUND, in order to assess the risk of its existing portfolio and future growth strategies, it reviews and confirms, on a quarterly basis, all financial assumptions and projections. This includes a detailed analysis of the results of operations and key business performance indicators, trends and changes that will impact the industry and EDFUND's performance in particular. Included in the review is assessing the loan volume forecasts over the various school segments and calculating the fiscal impact over a five-year period.

Finding #8: The EDFUND board has violated state law governing closed-session meetings.

The EDFUND board has not fully complied with certain provisions in state law related to closed-session meetings. Specifically, on August 11, 2004, the governor approved Senate Bill 1108, which amended state law to give the board the authority to hold a closed-session meeting to consider a matter of a proprietary nature, the public discussion of which would disclose a trade secret or proprietary business information that could potentially cause economic harm to EDFUND or cause it to violate an agreement with a third party to maintain the information in confidence if that agreement were made in good faith and for reasonable business purposes.

Our review of documents kept by EDFUND for open meetings held between August 19, 2004, and December 13, 2005, found that in one instance the board clearly violated its closed-session authority. The documentation indicates that the board voted to retain outside counsel to advise it on this audit, which clearly does not qualify as business proprietary information or a trade secret.

Additionally, the board did not consistently keep a confidential minutes book of the topics discussed and decisions made in these sessions, as the Bagley-Keene Open Meeting Act of 2004 (Bagley-Keene Act) requires. Consequently, we were unable to determine the extent to which the board complied with its recent statutory authority for closed sessions and the closed-session meeting provisions of the Bagley-Keene Act. When we asked EDFUND's assistant general counsel about the board's current record-keeping practices, she stated that the board recently was made aware that a closed-session minutes book should be maintained. The assistant general counsel asserted that the board now uses a confidential minutes book that will be maintained by the board secretary or general counsel.

We recommended that Student Aid ensure that EDFUND complies with the Bagley-Keene Act record-keeping requirements by maintaining a confidential minutes book of the business discussed during its closed sessions. In addition, Student Aid and EDFUND should establish policies and procedures to help ensure that closed sessions are conducted within the board's authority as required by state law. These policies and procedures should provide the board and staff with clear guidelines in defining trade secrets and business proprietary information that can be discussed during closed sessions so that no further violations of state law occur.

Student Aid's Action: Corrective action taken.

Student Aid reported that EDFUND is maintaining closed session minutes. In addition, Student Aid reported that a policy governing closed session meetings was adopted by the commission and the EDFUND board on April 9, and April 20, 2006, respectively.